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No. ——

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

THE BOARD OF ADMINISTRATION OF THE PUBLIC EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF CALIFORNIA, *et al.*, *Petitioners*,

v.

PETE WILSON, Governor of the State of California; GRAY DAVIS, State Controller of the State of California; KATHLEEN BROWN, State Treasurer of the State of California; and THOMAS W. HAYES, Director of the Department of Finance, State of California, *Respondents*.

Petition for a Writ of Certiorari to the Court of Appeal of California Third Appellate District

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a State's decision to impair its own contractual obligation solely in order to save public monies violates the Contract Clause of the United States Constitution.

2. Whether clear, mandatory state constitutional and statutory provisions governing the terms of a public employee pension plan are protected under the Contract Clause of the United States Constitution, where the State traditionally has viewed its pension obligations as contractual.

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PETE WILSON, Governor of the State of California; GRAY DAVIS, State Controller of the State of California; KATHLEEN BROWN, State Treasurer of the State of California; and THOMAS W. HAYES, Director of the Department of Finance, State of California,
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PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully request that a writ of certiorari issue to review the judgment of the Court of Appeal of California, Third Appellate District.[1]

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[1] Petitioner, The Board of Administration of the Public Employees' Retirement System of the State of California, was a

OPINIONS BELOW

The opinion of the California Court of Appeal is reprinted in the Appendix ("Pet. App.") at 1a. The court's order modifying that opinion is reprinted at Pet. App. 44a. The opinion, without modifications, is reported in the advance sheets at 6 Cal. Rptr. 2d 77. The opinion as modified will appear at the same cite in the bound volumes. The court's opinion denying rehearing is unreported and reprinted at Pet. App. 46a.

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nominal respondent below because California law requires it to enforce the challenged statute even if it disputes its validity. Cal. Const. art. III, § 3.5(a). The Board is nevertheless authorized to contest the lawfulness of the statute, as it has throughout these proceedings. *See* Pet. App. 1a-2a.

The other petitioners in this Court are Peggy J. Claypool; Ivory Blunt; Raymond Campbell; Robert Copp; Roy Cuckovich; Clara H. Dieterle; Milton Dobkin; Arthur Hayes; Alan Hardy; Elnora E. Hoyt; Robert Katz; Andrew J. Legg; Dixie Lowder; John B. Matheny; Jerry Matthews; N. Deane Moore; Linda L. Pinkerton; Yolanda Solari; John H. Thompson; Fran Victor; Marshall Walker III; Candy Workman; The American Federation of State, County, and Municipal Employees, AFL-CIO; Association of California State Attorneys & Administrative Law Judges; California Association of Highway Patrolmen; California Association of Professional Scientists; California Association of Psychiatric Technicians; California Department of Forestry Employees Association, AFL-CIO; California Federation of Teachers, AFL-CIO; California Professional Firefighters, AFL-CIO; California Independent Public Employees Legislative Council; California School Employees Association; California State Employees Association; California State Firefighters' Association, Inc.; California State University Emeritus and Retired Faculty Association; California Union of Safety Employees; Professional Engineers in California Government; Retired Public Employees' Association; Sacramento Area Firefighters, Local 522, IAFF, AFL-CIO; and Service Employees International Union, AFL-CIO. The parties in the courts below consist of these petitioners, the respondents listed in the caption here, and one other original petitioner, the Sacramento Police Officers Association.

No petitioner has any disclosure to make under Rule 29.1.

JURISDICTION

The judgment of the California Court of Appeal was entered on March 12, 1992, and timely petitions for rehearing were denied on April 13, 1992. On June 18, 1992, the California Supreme Court denied timely petitions for review. On August 14, 1992, Justice O'Connor extended the time for filing a petition until October 16, 1992. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the Contract Clause of the United States Constitution (art. I, § 10), as well as several provisions of California statutory and constitutional law. The Contract Clause provides that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." The pertinent California provisions are set forth at Pet. App. 53a, *et seq.*

STATEMENT

Petitioners seek review of a decision of the California Court of Appeal upholding a 1991 statute in which the California legislature responded to a fiscal crisis by (1) cutting benefits and eliminating protections in a pension program covering nearly a million public employees and retirees and (2) expropriating $1.9 billion of trust funds previously committed to pay pension benefits and using them instead to satisfy public employer obligations to the pension program. The constitutional challenge to this statute was primarily based on the Contract Clause, U.S. Const. art. I, § 10. The court below assumed that some of the changes made by the legislature did impair the contract rights of employees, but held that these impairments were constitutionally permissible. The court also held that other challenged features of the law did not involve contractually protected interests and thus did not implicate the Contract Clause.

1. *Factual Background.* The California Public Employees' Retirement System ("PERS") is a statutorily created program for paying retirement benefits to employees of the State, local school districts, various municipalities, and many other public bodies that have entered into contracts with PERS. Funds for these benefits come from fixed employee contributions, employer contributions calculated on an actuarial basis, and income earned on money already in PERS accounts. The system is administered by one of the petitioners here, the Board of Administration of the Public Employees' Retirement System, which serves as trustee of the funds. The other petitioners are current and former employees who are members of PERS, and organizations representing those members. *See generally* Cal. Gov't Code § 20000, *et seq.* (West 1980).

Under the PERS statute, all retiring employees receive a defined pension benefit, based on salary, age, and years of service, and a minimal cost-of-living adjustment (COLA), generally at the rate of two percent a year. Prior to July 1, 1991, the statute also had several other key features, which form the basis of the contractual claims at issue here. To begin with, it provided two types of supplemental benefits designed to protect pensioners from the effects of inflation above the two-percent, fixed COLA level. The Investment Dividend Disbursement Account (IDDA), originally enacted on a temporary basis in 1982 and made permanent in 1988, provided a PERS member with the right to a supplemental benefit ensuring that his pension maintained 75 percent of its original purchasing power, when the PERS Board determined that sufficient funds were available for this purpose. Cal. Gov't Code § 21235 (West Supp. 1989). The Extraordinary Performance Dividend Account (EPDA), created in 1988, provided a PERS member with the right to a second supplemental benefit, protecting the original purchasing power of his pension beyond the 75 percent level, when the Board determined that sufficient funds were available. *Id.* § 21238.

The IDDA and EPDA benefits were both funded entirely with "excess" earnings on money from *employee* contributions to PERS. Under the pre-1991 statute, the PERS Board was authorized to decrease the earnings credited to the employees' contributions down to the actuarially predicted rate, in order to create a surplus to pay these supplemental benefits. *See id.* §§ 20026, 20026.1, 20131, 20684 (West 1980 & Supp. 1989). The actual earnings on employee contributions, if they exceeded these pre-set estimates, were allocated to the IDDA and EPDA. *Id.* §§ 21235(a), 21237(b) (West Supp. 1989).[2] From its inception in 1983 until 1991, the IDDA benefit had been paid at the 75 percent level every year, and the EPDA benefit, first paid in 1991, brought the level to 80 percent. By 1991, moreover, $1.9 billion had accumulated in these accounts and were being held as reserves to pay IDDA and EPDA benefits in the future.[3]

In addition to making the key decisions regarding funding and payment of the IDDA and EPDA benefits, the PERS Board, for some forty years prior to 1991, had overall statutory authority for the financial soundness of the program, which included responsibility for setting employer contribution levels on the basis of actuarial analyses. *Id.* §§ 20127, 20130, 20750.9. (West 1980). The Board is an independent state agency, made up of six members who are either state officials or gubernatorial appointees, six members elected by employees and pension recipients, and one public member selected by the leaders of the legislature. *Id.* § 20100 (West Supp. 1992).

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[2] In practice, the estimated rate was set at 8.5 percent, while actual earnings during the 1980s consistently were at least 1.5 percent higher.

[3] A third benefit paid out of these funds, referred to in the opinion below as the "Boatwright benefit" (Pet. App. 6a), was a precursor to the IDDA benefit and was gradually being subsumed into it, and thus, for simplicity's sake, we omit any discussion of it.

In 1991, California faced a large budget deficit. In response, the legislature, with extreme haste, enacted the statute challenged here.[4] This statute, commonly referred to as "Chapter 83" (1991 Cal. Stat. ch. 83), made major changes affecting the pension rights just described.

First, the legislature repealed the pre-funded IDDA and EPDA benefits, replacing them with a new supplemental benefit program, to be funded out of current-year income on employee accounts. Under this program, retirees are entitled to receive up to (but not more than) 75 percent of the original purchasing power of their pensions, subject to the availability of funds. Ch. 83, § 36 (codified at Cal. Gov't Code § 21235.5). Funding for this new benefit comes largely from an annual transfer of up to 1.1 percent of the employee assets held by PERS; and funds cannot accumulate from one year to the next. *Ibid.*[5]

Second, the legislature directed that all of the $1.9 billion of trust funds then existing in the IDDA and EPDA reserves "be used to reduce employer contributions in fiscal year 1991-92 and subsequent fiscal years until those amounts are depleted." *Id.* § 17 (codified at

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[4] The various legislative proposals that led to this statute were only circulated during a two-week period prior to its passage. Certain key features, including the transfer of actuarial responsibility from the PERS Board to a political appointee, were not even proposed until the same day that they were passed, without hearings, by the legislature. *See* Decl. of David Low (attached to Petitioners' Reply Memorandum in the Court of Appeal, filed November 22, 1991).

[5] A minor amount of additional funding comes from a new cap on the interest rate paid to those employees who withdrew their individual accounts if they leave public service prior to retirement. *See* ch. 83, § 29.5 (codified at Cal. Gov't Code § 20652.5).

Cal. Gov't Code § 20131.01). This meant that state and local employers were relieved of their obligation to make current contributions to the PERS Fund.

Third, the new statute transferred actuarial responsibility for the program's financial soundness from the PERS Board to an actuary appointed by the Governor, with the consent of the legislature. *Id.* §§ 5, 6, 14, 31 (codified at or amending Cal. Gov't Code §§ 20006, 20006.1, 20130, 20750.905). Consequently, it is now up to this contract actuary, in his discretion, to determine the required amount of the State's contributions to PERS.[6]

2. *Proceedings Below.* Petitioners challenged these three aspects of Chapter 83 in an original action in the California Court of Appeal, claiming, *inter alia*, that they unconstitutionally impaired the contract rights of PERS members.[7] The Court of Appeal rejected each claim. As to the first—the elimination of IDDA and EPDA benefits—the court "assumed" for purposes of its analysis that employees who worked after January 1, 1989, when these benefits were permanently established by statute, had a contractual right to them. Pet. App. 20a.[8] Despite this right, however, the court held that

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[6] Chapter 83 also provided that certain future state employees would be required to enter a "second tier" pension system, under which the employees make no contributions, employer contributions are capped at a fixed level, and lesser benefits are paid. Such new employees may only participate in a contributory system if and when the State and the employees' representatives agree to a pension program that maintains the second-tier caps on employer contributions. Ch. 83, § 7 (codified at Cal. Gov't Code § 20013.75).

[7] Petitioners also raised state law claims and claims under the Due Process Clause of the United States Constitution.

[8] The court ruled that employees who had retired prior to 1989 did not have a contractual right to the IDDA and EPDA benefits, because EPDA did not exist at a time when they worked and IDDA was only a temporary program then. Pet. App. 15a-19a.

the State's unilateral elimination of the IDDA and EPDA benefits, coupled with its creation of the new supplemental benefit, did not violate the Contract Clause.

The court reached this result by applying a two-part test traditionally used in California (and numerous other States, *see* p. 25 *infra*), which provides that state-imposed changes to a pension contract with public employees are constitutionally permissible as long as (1) the changes " 'bear some material relation to the theory of a pension system and its successful operation,' " and (2) any changes that result in " 'disadvantage to employees [are] accompanied by comparable new advantages.' " Pet. App. 15a (quoting *Betts v. Board of Admin.*, 582 P.2d 614, 617 (Cal. 1978)). In this case, the court concluded, the basis for the change—"the saving of public employer money [that would otherwise have had to have been paid to PERS]"—was properly related " 'to the theory of a pension system and its successful operation.' " Pet. App. 20a-22a. The court also ruled that the second part of the test was satisfied here, finding that the new supplemental benefit is "comparable" to the repealed IDDA and EPDA benefits. *Id.* at 22a-27a.

The court next held that the diversion of the existing $1.9 billion in reserves (earnings on employee contributions that had been earmarked for supplemental employee benefits) to fund current employer contributions to PERS did not contravene petitioners' contract right to have PERS trust funds used "for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." Cal. Const. art. XVI, § 17(a) (added in 1984). The court reasoned that, although the $1.9 billion was being used to pay employer contributions to PERS, the monies themselves would, quite literally, "remain PERS assets until

they are paid to PERS members or beneficiaries or to defray the costs of administration of the system." *Id.* at 33a.

Lastly, the court rejected petitioners' claim that the transfer of actuarial responsibility, including the authority to set the level of employer contributions, from the independent PERS Board to an actuary appointed by the Governor, violated their contract rights. Despite the statutory provisions expressly conferring this procedural protection on petitioners (p. 5 *supra*), the court concluded that there is "no ground for implying a statutory promise that the duty of performing these functions would not be transferred to another entity." Pet. App. 41a.

The California Supreme Court denied petitions for review, Justices Stanley Mosk and Joyce Kennard dissenting.

REASONS FOR GRANTING THE WRIT

This case presents two important issues concerning the application of the Contract Clause of the United States Constitution, art. I, § 10, cl. 1.

First, the California Court of Appeal ruled that the State's interest in saving money provides a constitutionally adequate basis for it to impair its own contracts. This Court, however, has already rejected that view: "If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." *United States Trust Co. v. New Jersey*, 431 U.S. 1, 26 (1977) (footnote omitted). In any event, if, as it appears from the decision below, there remains some doubt about this basic proposition of constitutional law, this Court should clarify it before other States faced with similar financial pressures follow California's example.

Second, the California Court of Appeal ruled that, despite clear, pre-existing statutory mandates protecting employees, no contract rights were implicated by amendments that (a) siphoned off almost $2 billion of trust funds already committed for employee benefits in order to satisfy employer obligations, and (b) substituted a political appointee for an independent board as the party responsible for decisions affecting the required amount of future employer contributions to the trust fund. This process of "interpreting" contract rights in a way that nullifies Contract Clause claims raises special concerns because it effectively allows a State to avoid constitutional scrutiny of its own self-serving actions. To correct that kind of abuse—and to remind the lower courts that the Contract Clause has "not become a dead letter" (*Indiana ex rel. Anderson v. Brand*, 303 U.S. 95, 100 (1938))—the need for this Court to review state law rulings in Contract Clause cases remains a constitutional imperative.

This case presents an appropriate vehicle for considering these issues. The rulings below reflect a deep confusion concerning the application of basic Contract Clause principles to long-term, ongoing state obligations that arise under public employee pension programs. The state courts are in considerable disarray over this constitutional issue. Several states generally follow California's flexible Contract Clause approach to pension modifications (using the two-part test employed here), while others impose a more demanding standard of constitutional scrutiny. *See* p. 25 *infra* (citing cases). The need to clarify the law in this area is especially great now: numerous states and localities currently face substantial deficits, thus heightening the political temptation to raid well-funded public employee pension plans; and, unless corrected, the decision in this case is certain to embolden other state and local governments.

I. THE STATE'S INTEREST IN SAVING MONEY IS A CONSTITUTIONALLY IMPERMISSIBLE BASIS FOR IMPAIRING ITS CONTRACTS.

The California Court of Appeal assumed that employees who worked after January 1, 1989, had a right under their employment contracts to receive IDDA and EPDA benefits in accordance with the terms of the statutory provisions that were in effect when they rendered their services. The court nevertheless held that the State is free to disregard such a contractual obligation solely in order to save itself money, as long as it provides another benefit—found to be "comparable" by a court, though not by the party who holds the contract right. This view of the Contract Clause is seriously flawed. If that provision is to have any force, a State's decision to renege on an agreement simply because it is "too expensive" must be constitutionally impermissible. That fundamental conclusion is not altered by adding a self-contradictory "comparability" prong to the constitutional inquiry.

1. The language of the Contract Clause is unequivocal: "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." Nevertheless, this Court has held that "the prohibition is not an absolute one" because the Clause cannot sensibly be read to divest a State of the "essential attributes of sovereign power." *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 428, 435 (1934). Thus, "an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose." *United States Trust Co.*, 431 U.S. at 25.

This general standard is applied "more stringent[ly]" (*Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 n.15 (1978)) when, as here, the State impairs its own contracts, because then "the State's self-interest is at stake." *United States Trust Co.*, 431 U.S. at 26. Indeed, "[i]n almost every case, the Court has held a governmental unit to its contractual obligations when it

enters financial or other markets." *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 412 n.14 (1983) (citing cases); *see also United States Trust Co.*, 431 U.S. at 24 ("the Court has regularly held that the States are bound by their debt contracts") (footnote omitted); *cf. Murray v. Charleston*, 96 U.S. 432, 445 (1878) ("[t]he truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties").

Specifically as regards this case, the Court has made clear that the Contract Clause flatly prohibits a State from impairing its contractually imposed "financial obligations" so that it can "spend the money for what it regard[s] as an important public purpose." *United States Trust Co.*, 431 U.S. at 26. As the Court recognized in that case, were such a money-saving justification deemed constitutionally permissible, "the Contract Clause would provide no protection at all." *Ibid.* Following this lead, the federal courts of appeals have rejected money-saving impairments even when the State faces enormous, unanticipated financial burdens under a contract, and even when the State is in the midst of a fiscal crisis. *See Continental Illinois Nat'l Bank & Trust Co. v. Washington*, 696 F.2d 692, 696 n.8, 701-02 (9th Cir.), *appeal dismissed*, 460 U.S. 1077 (1983) (State barred from restricting authority of public agency to sell bonds, as provided by contract, where it sought to avoid unforeseen obligations totalling billions of dollars); *Association of Surrogates & Supreme Court Reporters v. New York*, 940 F.2d 766 (2d Cir. 1991) (State cannot suspend employees' contract right to salaries in order to provide funds needed for operating the judicial system).

This fundamental limitation on a State's ability to impair its own contracts is directly tied to the reason for relaxing the Contract Clause's unequivocal mandate in the first place. It is one thing to fashion a doctrine,

based on necessity, growing out of the recognition that certain police-power options—*e.g.*, protecting public safety—cannot be contractually limited if the State is to be able to govern. *See Stone v. Mississippi*, 101 U.S. 814, 817 (1880) ("[t]he legislature cannot bargain away the police power of a State"); *United States Trust Co.*, 431 U.S. at 23-24 & n.20 (citing cases). But, for several reasons, it is a very different thing to say that hard financial times should allow a State to abandon its freely undertaken contractual obligations. Most importantly, there is no real "necessity" in this latter situation; other spending cuts or revenue increases, though often unpopular, are always available. Moreover, in contrast to situations where unforeseen circumstances may create a need for flexibility, state-contracted debts typically will be (as here) readily foreseeable. And finally, a State obviously has wide discretion to set or reject contract terms at the outset when it is dealing in traditional commercial areas like employment or product acquisition.

2. The California Court of Appeal's decision never came to grips with these settled constitutional principles. Instead, the court quickly concluded that a money-saving purpose is permissible, at least when the State "provide[s] comparable advantages to the employees whose contract rights are modified." Pet. App. 22a. In so ruling, the court purported to be applying a two-part test previously adopted by the California Supreme Court, which provides that "a modification of a vested pension right is reasonable only if it 'bear[s] some material relation to the theory of a pension system and its successful operation, and changes in [it] which result in disadvantage to employees [are] accompanied by comparable new advantages.'" *Id.* at 20a (quoting *Betts*, 582 P.2d at 617).[9] This analysis is pervasively unsound: the test,

[9] The California Supreme Court has made clear that this two-part test is based on the application of this Court's "[Contract Clause] principles to the modification of rights arising under the retirement

on its face, makes no sense in this context; the substitution of a court's assessment of benefit comparability for that of the contracting party cannot legitimate an otherwise impermissible reason for impairing a contract; and the court's finding of comparable-benefits-for-less-money here cannot withstand scrutiny.

a. The two-part test used by the court below, while enjoying a lengthy pedigree in California pension cases, has never before been applied in this fashion. The test was established "for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system." *Allen v. City of Long Beach*, 287 P.2d 765, 767 (Cal. 1955). In accord with that purpose, previous California cases demonstrate that this test is designed to allow the State to make modifications that *improve* the overall quality or security of pension plans. *See, e.g., Houghton v. City of Long Beach*, 330 P.2d 918, 922 (Cal. Ct. App. 1958) (imposition of employee contribution requirement validly offset by the city's new commitment that pension would be a general obligation, rather than a right conditioned on availability of funds); *Downey v. Board of Admin.*, 121 Cal. Rptr. 295, 303 (Ct. App. 1975) (contribution increase validly offset by increase in benefits).

Whatever its merit in that kind of situation, however, this test cannot sensibly be applied to assess the validity of benefit changes made for the express purpose of saving an employer money. The simple fact is that the State cannot save money by substituting one benefit for another, while simultaneously making the new benefit "comparable" to the old. After all, pension benefits are nothing but

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laws of this state." *Allen v. Board of Admin.*, 665 P.2d 534, 538 (Cal. 1983) (citing, *inter alia, United States Trust Co., supra; City of El Paso v. Simmons*, 379 U.S. 497, 508 (1965)). *See also Betts v. Board of Admin.*, 582 P.2d at 619 (failure to meet two-part test means pension modification "cannot constitutionally be applied").

monetary payments and thus a cheaper benefit is just not a comparable one. Until this case, therefore, the California courts uniformly struck down these kinds of money-saving impairments of contract rights. *See, e.g., Betts v. Board of Admin., supra; California Teachers Ass'n v. Cory*, 202 Cal. Rptr. 611 (Ct. App. 1984); *Valdes v. Cory*, 189 Cal. Rptr. 212 (Ct. App. 1983).

b. More fundamentally, the Court of Appeal's approach impermissibly compresses the constitutional inquiry. This Court has insisted that, to pass muster, contractual impairments must be both "reasonable" *and* "necessary to serve an important public purpose." *United States Trust Co.*, 431 U.S. at 25. But in California, it now appears that a contract right can be abrogated simply if a new right, judged "comparable" by a court, is provided in its stead. *See* Pet. App. 22a ("[w]e hold only that the monetary objective will not invalidate a modification which [provides comparable advantages to the employees]"). This complete elimination of the "necessity" prong in Contract Clause analysis (even assuming that "comparability" is a proper surrogate for "reasonableness") guts the standard of any constitutional legitimacy.

The whole theory of contract law rests on the notion that "parties may contract as they wish, and courts will enforce their agreements without passing on their substance." *Restatement (Second) of Contracts*, ch. 8, intro. note (1981). The constitutional approach followed by the court below, however, simply disregards this paramount principle and allows the courts to decide that a second contract right is about as good as the first. In sharp contrast, this Court's requirement—that a State show its impairment of a contract is "necessary to serve an important public purpose" (*United States Trust Co.*, 431 U.S. at 25)—properly ties the Contract Clause to the underlying theory of contract law, by insisting that the parties' evaluation of the bargain will be enforced *unless* there is an overriding state interest present. Only when

that preliminary condition is satisfied, we submit, is it even relevant to look into the reasonableness of the impairment, a consideration that *is* rightly affected by comparability considerations. *See United States Trust Co.*, 431 U.S. at 29-32; *see also General Motors Corp. v. Romein*, 112 S. Ct. 1105, 1109-10 (1992); *Allied Structural Steel Co.*, 438 U.S. at 242-51.

c. The California Court of Appeal's analysis of "comparability" confirms, on a practical level, that its approach does not meaningfully protect the constitutional rights of contracting parties. The court was able to find comparability between the old and the new supplemental benefit programs here only by ignoring relevant factual issues and by relying on highly questionable actuarial projections. If the court had conducted a complete and correct analysis, it would have come to the obvious conclusion that the State could save money by eliminating contract rights to the IDDA and EPDA benefits only because it provided a less-than-comparable substitute.

To start with, the court focused on whether the reduction in the *maximum* benefit (from 80 percent then being paid under EPDA to 75 percent under the new system) would in fact affect post-1988 retirees. It concluded that, by the time these retirees became eligible for supplemental benefits, there would no longer have been funds available to pay EPDA benefits. In so doing, the court relied on disputed projections of future funding and on the fact that future employee contributions would be reduced by the diversion of new state employees into a non-contributory plan. But this conclusion—acknowledged by the court to be key to its comparability finding—rests in no small part on guesswork, such as "assuming a 5 per cent inflation rate" over a period of "*nine* years." Pet. App. 24a (emphasis added). Indeed, petitioners submitted testimony showing that these projections generally were based on unlikely, "worst-case" assumptions. *See* Decl. of Stephen J. Hoeffner (attached to the Letter Brief

of the PERS Board in the Court of Appeal, filed November 22, 1991). Moreover, the diversion of new state employees into a non-contributory pension plan was largely irrelevant to a reasoned analysis of future benefits.[10]

To make matters worse, the court gave only passing consideration to the overall comparability of the new and old benefits *below* the statutory maxima. When that issue is looked at, it becomes apparent that Chapter 83 is demonstrably less beneficial than the IDDA and EPDA program, because the funds for the new benefit are capped at *1.1 percent* of the monies in employee accounts in a given year,[11] whereas funding for IDDA and EPDA benefits always had exceeded *1.5 percent* of these monies. Moreover, under the old program, but not the new one, reserves were carried forward over the years, thus allowing a good year to cushion the effect of a bad one and thereby substantially increasing the financial security of

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[10] This diversion covered only about one-fourth of PERS members (the others being non-state members) and, by statute, even these state members will participate in a contributory plan if one is negotiated with their unions. Ch. 83, § 7 (codified at Cal. Gov't Code § 20013.75). More importantly, under the IDDA and EPDA program, a loss of contributions from *state* employees would not have significantly affected the benefits for local and school employees—because funds for separate categories of employees were kept in separate "purchasing power accounts." *See* Decl. of Edward H. Friend, at 9 (attached to the Petition for a Writ of Mandamus in the Court of Appeal, filed July 30, 1991). The new supplemental benefit does not maintain such a separation, thus making it likely that all members will suffer if new state employees remain in a noncontributory plan. *See ibid.*

[11] In addition to the 1.1 percent diversion, the new system also funds supplemental benefits by reducing to 6 percent the interest paid when employees leave public service before retirement and seek a distribution of their individual contribution accounts. But the sums produced in this way are, relatively speaking, *de minimis*. *See* Decl. of Edward H. Friend, *supra*, at 7 n.2.

future payment levels.[12] Indeed, as noted, the IDDA and EPDA reserves, at the time they were expropriated by the State, had reached the level of $1.9 billion.

These various differences between the two benefits—which, of course, represent the money-saving dimension of the contract modification—amply demonstrate the inherent illogic of trying to harmonize two irreconcilable objectives—money saving and comparability. They also illustrate why a court should be hesitant to substitute its own *post-hoc* assessment of contract benefits for that of the contracting parties. It is hard to imagine that employees covered by the court's analysis would not have strongly preferred the IDDA and EPDA program to Chapter 83. That supposition is convincingly confirmed by the fact that they have pursued this litigation.

II. THE CALIFORNIA COURT OF APPEAL'S PATENT MISREADING OF STATE LAW ERRONEOUSLY DEFEATED IMPORTANT CONTRACT RIGHTS.

The court below compounded its error by rejecting two major aspects of petitioners' challenge to Chapter 83 on the ground that the disputed modifications did not affect existing contract rights. In particular, petitioners claimed violations based on (1) the use of $1.9 billion of trust funds—which represented earnings on employee contributions that had already been statutorily committed to fund employee benefits—in order to satisfy employer obligations to PERS, and (2) the transfer of overall actuarial responsibility for PERS from an independent board to a single political appointee. The California Court of Appeal's conclusion that these contentions have

[12] This protection significantly undercuts the importance of the fact, noted by the court below (Pet. App. 23a), that funding was variable under the old system but is permanently set at 1.1 percent under the new one.

no basis in state law (and, therefore, raise no federal law issues) is plainly wrong: the claimed contract rights are set forth in unmistakably clear state law constitutional and statutory provisions that define the terms of the pension contract.

This use of state law to insulate Contract Clause claims from potential review by this Court should not go unchecked. More than fifty years ago, the Court held that "in order that the constitutional mandate may not become a dead letter, we are bound to decide for ourselves whether a contract was made, what are its terms and conditions, and whether the State has, by later legislation, impaired its obligation." *Indiana ex rel. Anderson v. Brand*, 303 U.S. at 100; *see D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 470 (1942) (Jackson, J., concurring). But, despite that recognition, the Court has rarely agreed to scrutinize lower court decisions that find no contract rights, especially in state-contract cases. Unless the trend is reversed, the Contract Clause will indeed, as this case demonstrates, "become a dead letter." *Anderson*, 303 U.S. at 100.

1. The Court of Appeal held that the California legislature violated no contract right when it took $1.9 billion of PERS trust funds that had been set aside to pay employee benefits and used them instead to satisfy the employers' obligation to make further contributions to the pension system. The court implicitly assumed that the employees' pension contract contained a "trust" provision, requiring that funds be used only to pay benefits (and administrative costs), but concluded that the State's action here did not violate this provision since the $1.9 billion would still be used, in the literal sense, for such purposes. That hollow analysis dishonors the contract right at issue. The fact that the diverted funds are ultimately used for the proper purpose of paying *employees'* benefits cannot validate the prior improper diversion of those trust funds to pay the *employers'* contributions.

Indeed, this particular right was added to public employee pension agreements precisely in order to prevent what happened here. In 1982, the California legislature had made a similar attempt (though much smaller in magnitude) to pay employer contributions out of earnings on employee contributions to the PERS fund that had been set aside to protect employee benefits. *See Valdes v. Cory*, *supra* (describing these events). In direct response, a proposed constitutional amendment was submitted to the voters in 1984, providing that "[t]he assets of a public pension or retirement system are trust funds and shall be held for the exclusive purpose of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." Cal. Const. art. XVI, § 17a. The ballot arguments in support of this amendment explained that it would (1) " 'guarantee[] that neither the Governor nor future Legislatures will ever be able to use this money for other purposes,' " (2) assure that " 'the *only purpose* for which these trust assets can be used is the delivery of retirement benefits,' " and (3) enact " 'the *sole and exclusive purpose rule* which imposes on fund trustees the legal obligation to perform their duties *solely* in the interest of plan beneficiaries.' " Pet. App. 32a-33a (quoting Ballot Pamp., argument in favor of Proposition 21 as presented to the voters, Prim. Elec. (June 5, 1984), at 26) (emphasis in original).[13] By passing this amendment, the people of California imposed on the legislature the highest duty of trust law—the duty of undivided loyalty—utilizing words having

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[13] A second subsection of this amendment authorizes "[t]he fiduciary of the public pension or retirement system" to, *inter alia*, "minimiz[e] employer contributions thereto." Cal. Const. art. XVI, § 17(b), *quoted at* Pet. App. 32a n.7. The court below properly rejected the State's reliance on this provision, explaining that "[t]he argument is a digression since the subdivision . . . refers to the duties of the trustees and not, save perhaps derivatively when legislating upon that topic, to the duties of the Legislature which are in issue here." Pet. App. 32a n.8.

long-established meaning under trust law. *See NLRB v. Amax Coal Co.*, 453 U.S. 322, 329 (1981) (use of phrase "sole and exclusive benefit[s]" carries with it an "accumulated settled meaning" that "trustee bears an unwavering duty of complete loyalty to the beneficiary of the trust, to the exclusion of all other parties") (citing *Restatement (Second) of Trusts* § 170(1) (1957); 2 A. Scott, *Law of Trust* § 170 (1967)).

These events confirm the common-sense conclusion that trust monies earmarked "solely" for the use of beneficiaries cannot lawfully be diverted to serve the interests of other parties. *Cf. Mosser, Successor Trustee v. Darrow, Former Trustee*, 341 U.S. 267, 271-72 (1951) (trustee may not administer trust to benefit third parties). Instead, these monies should have been retained for their intended purpose—guaranteeing future supplemental benefits [14]—or at minimum returned to the individual *employee* accounts from which they were initially diverted.[15] These options would have allowed the trust's beneficiaries to benefit from the income on their own contributions.

To be sure, it happens to be true that the funds diverted to pay employer contributions "remain PERS assets until they are paid to PERS members or beneficiaries or to defray the costs of administration of the system." Pet. App. 33a. But the substantive effect of this aspect of Chapter 83 is no different than

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[14] As noted above, the size of the *new* supplemental benefit COLA depends on the availability of funds. Thus, even assuming, contrary to our view, that IDDA and EPDA could have been eliminated, the $1.9 billion could have been used to forestall the possibility of a shortfall resulting from increased inflation.

[15] If this action had been taken, employees would have received benefits associated with larger individual accounts (more money available for early withdrawal as well as higher death benefits). *See* Cal. Gov't Code §§ 20652, 21332, 21360, 21361 (West 1980 & Supp. 1992).

if the "Legislature [had] actually appropriated . . . the PERS trust funds for purposes unrelated to the benefit of PERS members, *e.g.*, to balance the state budget." *Valdes*, 189 Cal. Rptr. at 224. Indeed, if this money had simply been given to charity, employees would have been no worse off: *employer* contributions would have increased, but *employee* benefits (and the funds available to pay them) would have remained unchanged. Surely this reality, and not which bank account the contested money ultimately ended up in, must govern the application of the trust obligation that is a part of the PERS pension contract under California law.[16]

2. The California Court of Appeal's disregard of clear contract rights is equally apparent with respect to Chapter 83's transfer of actuarial responsibility from the PERS Board to an actuary appointed by the Governor. There is no question that employees had a pre-existing statutory right to have the independent PERS Board carry out these functions. Thus, beginning in 1945 and continuously until 1991, the PERS Board was required to assess the value of PERS assets and project the future income and liabilities of the pension program. Cal. Gov't Code §§ 20127, 20130 (West 1980). Based on these assessments and projections, in turn, the Board was then required to determine the magnitude of employer contributions that would, when combined with the fixed employee contributions, produce adequate funding of the system. *Id.* § 20750.9. Such determinations, of course,

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[16] Further betraying its confusion, the court below also asserted that "[t]he use of [this $1.9 billion] to meet the employers' continuing funding obligation is no more proscribed by article XVI, section 17, than is the use of earnings attributable to the *employer* accounts of the PERS fund for the same purpose." Pet. App. 33a (emphasis added). But the contract right at issue here, self-evidently, does not prevent the use of *employer* funds to reduce *employer* obligations; it only bars the use of already dedicated employee funds to pay the employer's obligation to fund a different benefit.

involve a great deal of discretionary judgment. The evident purpose of entrusting them to the carefully balanced PERS Board (*see* p. 5 *supra*) was to assure that basic funding decisions would be insulated from political manipulation by the State, including efforts to minimize current employer costs that might put the pension rights of employees at financial risk.

It is difficult to see how this kind of core structural protection—set forth in unequivocal statutory mandates—could not be considered a contract right. Surely employees would reasonably have viewed this feature of the terms of their employment as an important (and not incidental) element in the package of pension contract benefits. Indeed, the California Court of Appeal itself has previously stated that public employees have a right to those features of the system that assure "the security and integrity of the funds available to pay future benefits." *Valdes*, 189 Cal. Rptr. at 222. The use of the PERS Board to make the decisive actuarial decisions for the pension system obviously falls within this description. *See also California Teachers Ass'n v. Cory*, 202 Cal. Rptr. at 618 ("Pension rights can encompass the funding mechanism for the pension when there is a palpable element of exchange involving funding; continued service as a teacher in return for enhanced assurance that funds to pay the pension benefits will be available at retirement."). The Court of Appeal thus missed the point in concluding that there is "no ground for implying a statutory promise that the duty of performing these [actuarial] functions would not be transferred to another entity." Pet. App. 41a. There *are* grounds for concluding that the duty of performing these functions would not be transferred to another entity not insulated from political manipulation by the State.

The importance of the contractual protection provided by an independent decisionmaker is well illustrated by the facts presented here. The only possible reason for the legislature to reassign these actuarial functions would

have been its conclusion that the PERS Board was setting employer contributions at "too high" a level. Concomitantly, there must have been every expectation that an actuary, appointed through the political process, would find lower levels of employer contributions to be acceptable. That calculus, whatever its justification, can only have a negative impact on the pension rights of PERS members.

Notably, the only decisions that appear to have addressed similar kinds of structural protections in a public employee pension program support the view that they give rise to enforceable contract rights. Thus, in *Sgaglione v. Levitt*, 337 N.E.2d 592 (N.Y. 1975), the New York Court of Appeals held that it was an impairment of contractual rights, unconstitutional under the state constitution, for the legislature to have directed the State Comptroller to invest pension funds in a specific security. The Comptroller was, by statute, the trustee of the pension funds, "vested with discretion to make what he determines to be wise investments." *Id.* at 595. The court concluded that to strip him of the power to make independent decisions was to "remove a safeguard integral to the scheme of maintaining the security of the sources of benefits for over a half century." *Ibid. See also New Hampshire Retirement Sys. v. Sununu*, 489 A.2d 615, 619 (N.H. 1985) (concluding that State law did not authorize the Governor to review the personal service contracts of a public pension board in light of the potential conflict between the board's trust obligations and the Governor's broader concerns).

More recently in *McDermott v. Regan*, 1992 N.Y. Misc. LEXIS 378 (Sup. Ct. Aug. 10, 1992), the court dealt with a situation even closer to that presented here. The New York legislature, in a time of fiscal crisis, had mandated that the Comptroller change the actuarial method used to estimate the future funding needs of the pension system for purposes of determining the current rate of employer contributions. This new method authorized delayed ac-

crual of pension liabilities, thereby allowing the State to suspend its current contributions. Following *Sgaglione*, the court rejected the legislature's imposition of this modification, holding that employees had a contract right to "an independent trustee imbued with the discretion to protect their retirement funds." *Id.* at *9. The contract rights of California's PERS members compel the same conclusion in this case.

III. THIS CASE RAISES ISSUES OF GENERAL IMPORTANCE WARRANTING REVIEW BY THIS COURT.

There are several reasons why this case is appropriate for review by this Court. As we have already demonstrated, the California Court of Appeal's first holding, that financial concerns can justify a State's impairment of its own contracts, conflicts with this Court's precedents, which the court below ignored; and the court's second two holdings, finding no contract rights despite clear statutory mandates, are demonstrably wrong. These rulings, troubling in their own right, also reflect a broader problem of confusion among the state courts concerning the modification of public pension programs.

Thus, in those States where pension statutes are recognized as creating contract rights, there is a clear division between the many courts that have adopted California's elastic "material relation/comparable benefits" standard for modification, *see, e.g., Nevada Employees Ass'n v. Keating*, 903 F.2d 1223, 1227 (9th Cir. 1990); *Burlington Fire Fighters' Ass'n v. City of Burlington*, 543 A.2d 686, 690 (Vt. 1988); *Singer v. City of Topeka*, 607 P.2d 467, 475 (Kan. 1980), and others that require more demanding scrutiny, *see, e.g., Association of Pennsylvania State College & Univ. Faculties v. State Sys. of Higher Educ.*, 479 A.2d 962, 965-66 (Pa. 1984) (comparable new advantages insufficient to justify State's reduction of pension benefits); *Yeazell v. Copins*, 402 P.2d 541, 545 (Ariz. 1965) (existing pension statute may not be unilaterally

modified without consent of current employees). *See generally Wagoner v. Gainer*, 279 S.E.2d 636, 644 (W. Va. 1981) (describing this conflict).[17] In addition, as previously noted (*see* p. 24 *supra*), there is a direct conflict between the decision below and rulings in New York concerning the contractual status of statutory guarantees that funding decisions will be controlled by a specified independent fiduciary.

This confusion should be clarified, and these conflicts resolved, now. This case alone affects the rights of almost a million public employees in California. Beyond that, state and local governments throughout the country are currently engaged in efforts to use public pension funds to ameliorate their fiscal problems. *See* Deutschman, *The Great Pension Robbery*, Fortune, Jan. 13, 1992, at 76 ("In the past two years more than a third of the states have cut or delayed contributions to their pension funds, seized money outright from pension accounts, or begun to debate similar measures."); *see also* Zolkos, *Cash-Hungry States Scare Public Funds: Bulging Coffers Increasingly Seen as Prey*, Pensions & Investments, June 8, 1992; *The Pension Honey Pot*, Financial World, May 12, 1992, at 64; Mahar, *The Great Pension Raid: States and Corporations Hungrily Eye Retirement Nest Eggs*, Barron's, Dec. 2, 1991, at 8. Given this reality, the decision below, unless corrected, plainly has the potential for encouraging an invasion of public pension funds nation-

[17] Yet a third group of decisions holds that statutory guarantees of pension benefits are "gratuities" that create no contractual rights at all, until an employee retires. *See, e.g., Haverstock v. Indiana Pub. Employees Retirement Fund*, 490 N.E.2d 357, 360 (Ind. Ct. App. 1986); *Patterson v. City of Baton Rouge*, 309 So. 2d 306 (La. 1975); *Creps v. Board of Fireman's Relief & Retirement Fund Trustees*, 456 S.W.2d 434, 437 (Tex. Civ. App. 1970). *See generally*, Note, *Public Employee Pensions in Times of Fiscal Distress*, 90 Harv. L. Rev. 992, 993 (1977). California, however, has long recognized the contractual status of public-employee pension benefits. *See, e.g., Allen v. Board of Admin.*, 665 P.2d at 537; *Betts v. Board of Admin.*, 582 P.2d at 617.

wide—a concern strongly confirmed by the extensive *amicus curiae* participation below by public pension programs and affected beneficiaries from several other States and locales.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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Dated: October 16, 1992

APPENDICES

APPENDIX A

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT
(SACRAMENTO)

C011580

PEGGY J. CLAYPOOL *et al.*,
Petitioners,

v.

PETE WILSON, as Governor *et al.*,
Respondents.

[Filed Mar. 12, 1992]

ORIGINAL PROCEEDING: Application for a writ of mandate. Writ denied.

In this original mandamus proceeding members of the Public Employees' Retirement System (PERS) and their employee organizations (collectively Petitioners), challenge the constitutionality of two parts of chapter 83 of the Statutes of 1991 (Chapter 83). One part repeals three funded supplemental cost of living (Cola) programs and directs that the funds be used to offset contributions otherwise due from PERS employers. The other transfers the responsibility for actuarial determinations from the PERS Board to an actuary acting under a contract with the Governor.

Petitioners and their allies, the nominal respondent Board of Administration of PERS (PERS Board) and amicus curiae, contend that repeal of the supplemental

Cola programs and reallocation of the funds to offset employer contributions unconstitutionally impair the contract rights of PERS beneficiaries and, along with the transfer of actuarial functions, violate California Constitution, article XVI, section 17, which declares that the assets of a public pension or retirement system are trust funds.

The heart of the controversy has two chambers. One concerns the permissible uses of a unique fund within PERS amounting to some two billion dollars. The fund was generated from earnings on the investment of mandatory payroll contributions of employee members of the system. Ordinarily such earnings are accumulated to meet the basic pension obligations of the State and other PERS employers. Some were diverted to fund supplemental Cola benefits to retirees to aid in the preservation of the purchasing power of their pensions. Under Chapter 83 the statutes providing for the supplemental Colas are repealed, a new supplemental Cola program enacted, and the funds reallocated to meet the basic pension obligations of PERS employers.

Petitioners claim that this reallocation of investment earnings impairs the vested contract rights of PERS members. We will conclude that no contract rights are impaired. The principal beneficiaries of the fund, if not reallocated, are former employees who ceased employment prior to the time when an implied statutory promise not to reallocate the fund could have arisen. They earned no vested contract rights under the repealed statutes and must rely, along with present employees, upon a new supplemental Cola program enacted by Chapter 83 as a replacement for the repealed programs. The employees who may have earned vested contract rights by rendering service under the repealed statutes are given comparable advantages under the new supplemental Cola program and for that reason their rights are not unconstitutionally impaired.

The second chamber of the controversy concerns the transfer of PERS Board actuarial functions to an actuary selected by the Governor [the Actuary]. The key issue is whether the assignment of these matters to an outside actuary violates the requirement of California Constitution, article XVI, section 17, that PERS be managed as a trust. We will conclude that Chapter 83 contains safeguards which insulate the Actuary from the control of the Governor and that the transfer of actuarial functions is not facially inconsistent with trust law.

We will deny the petition.

FACTS AND STATUTORY BACKGROUND

The facts for the most part are contained in the history of the Public Employees' Retirement Law and matters subject to judicial notice. (See Valdes v. Cory (1983) 139 Cal.App.3d 773, 780; California Teacher's Association v. Cory (1984) 155 Cal.App.3d 494, 500, fn. 2.) Our point of departure is the opinion of this court in *Valdes* v. *Cory*. There we recounted the history of PERS to March 1982, the date of the enactment challenged in that case. (*Id.* at pp. 780-783.) We will revisit this history before relating subsequent developments. Except as we note, the statutes governing PERS have been substantially carried forward to the present.

A. *PERS History Prior to 1982*

In 1931 the Legislature established the State Employees' Retirement System, presently known as PERS. (Stats. 1931, ch. 700, § 25; Gov. Code, § 20004.)[1] The system included a fund derived from mandatory employee payroll contributions (member contributions), contributions of the state, and earnings on the investment of the fund. (Stats. 1931, ch. 700, §§ 41, 63, 65-74.) The

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[1] References to a section are to the Government Code unless otherwise specified.

member contributions were calculated to provide an average annuity at age 65 equal to one one-hundred-fortieth of a member's final compensation multiplied by the years of service. (*Id.*, § 65.) These contributions were deducted from the payroll of each office or department and the remaining salary payment was declared a full and complete discharge of the obligation owed an employee except for claims of benefits under the retirement law. (*Id.*, § 67.)

The system was administered by a board of administration. At the outset the PERS Board was directed to make actuarial valuations of the fund and the liabilities of the system and to recommend to the Legislature appropriate changes in the rates of contribution to achieve equality between valuation and liabilities. (Stats. 1931, ch. 700, §§ 51, 58, 69-72.)

Each year the PERS Board was to credit member contributions with four percent interest or such greater amount of interest as it deemed proper in light of the earnings on the fund in that year, but no more than actual earnings. (Stats. 1931, ch. 700, § 52.) An individual member account was kept for each member of the retirement system and was credited with the member's payroll contributions and with annual interest. (*Id.*, § 67.) The records and accounts of the PERS Board were directed to show the accumulated contributions of the State. (*Id.*, §§ 56-57.) If a member discontinued employment other than by death or retirement the member was to be paid the amount of his or her accumulated member contributions. (*Id.*, § 75.) A member was entitled to retire at age 60 with 20 years of service and to receive a retirement allowance consisting of an annuity equal to the value of the accumulated employee contributions together with a matching pension funded by the state contributions. (*Id.*, §§ 79-82.)

In 1937 a reserve against deficiencies was created. "Income, of whatever nature, earned on the retirement

fund during any fiscal year, in excess of the interest credited to contributions during said year shall be retained in said fund as a reserve against deficiencies in interest earned in other years, losses under investments, and other contingencies. (Stats. 1937, ch. 806, § 8; see now § 20203.) In 1939 the system was expanded to include any municipal corporation in the State which elected to contract with the PERS Board for coverage of its employees. (Stats. 1939, ch. 927, § 3b.) The law was also amended to provide that interest at the current rate rather than 4 percent should be the baseline credit to member contributions. (*Id.*, § 13.) In 1943 the system was expanded to include any public agency in the State which elected to contract with the PERS Board for coverage of its employees. (Stats. 1943, ch. 640.)

In 1945 the original enactments were repealed but the provisions in essential part were carried over as the State Employees' Retirement Law. (Stats. 1945, ch. 123, §§ 1-2; Gov. Code, §§ 20000-21455.) In 1947 the pension component of the retirement allowance was defined to be the amount, which, when added to the annuity component met prescribed target amounts based on age at retirement and final compensation. (Stats. 1947, ch. 732, § 4.) Under the present version of this provision, for example, a state miscellaneous member retiring at age 60 with 25 years of service is entitled to a retirement allowance of 2 percent of final compensation multiplied by the number of years of service, i.e., half-pay. (§ 21251.13.) This allowance is increased annually by a basic Cola limited to two percent per year. (§§ 21222, 21224.) Some other classifications of members have a higher basic Cola.

In the early years of the system the reserve against deficiencies was not substantial. "For years, the interest credited to accumulated contributions closely paralleled the actual earnings rate after deduction of administrative costs. Until 1971, the crediting rate was usually within one quarter of one percent of the earnings rate. In re-

cent years, however, the crediting rate has not kept pace with market rates of interest, resulting in a dramatic increase in the reserve account because of current record-high investment yields in financial markets. Consequently, the PERS currently [1982] has a reserve approaching $1 billion." (*Valdes* v. *Cory*, supra, 139 Cal. App.3d at p. 783.)

A consequence of the burgeoning reserve for deficiencies was the enactment of section 21231 in 1980. It established a special account within PERS and transferred from the reserve for deficiencies to the account monies exceeding two percent of PERS assets. (*Ibid.*) The purpose of this account was to increase by 10 percent for the period October 1, 1980, through September 30, 1982, the monthly allowance of every person eligible to receive an allowance on December 31, 1979. (*Ibid.*) We adopt the usage of the parties and refer to this benefit as the Boatwright benefit. Subdivision (c) of section 21231 provides that recipients of this benefit are to be informed that "the increases are not cumulative and shall not be included in their base allowance and may be available for only a limited period of time."

In March 1982, chapter 115 was enacted. The provisions of this enactment, challenged in *Valdes* v. *Cory*, directed that employer contributions, payable for a portion of that year, not be paid and that the PERS Board make up the shortfall by transfer of an equivalent sum from the reserve against deficiencies. (Stats. 1982, ch. 115, §§ 14, subd. (b), 58-61.) The PERS Board adopted a resolution declining to make this transfer until compelled so to do by a final judgment of an appellate court. (*Valdes* v. *Cory*, supra, Cal.App.3d at p. 779.) This led to the *Valdes* v. *Cory* litigation.

B. *Chapter 330 of the Statutes of 1982*

In June 1982, chapter 330 was enacted. Section 1 states the legislative intent of the enactment in pertinent part as follows.

> "It is the intent of the Legislature in enacting this act to preserve the actuarial integrity of the Public Employees' Retirement System, to recognize the fiduciary role of the Board of Administration of the Public Employees' Retirement System, to assist in the orderly and equitable disposition of the reserve against deficiencies created by Section 20203 of the Government Code, and to provide for repayment of state and school employer retirement contributions. In enacting this act, the Legislature agrees with the findings of the chief actuary and the board, who, on June 16, 1982, determined that funds in the reserve for deficiencies may be allocated from the reserve without jeopardizing the actuarial soundness of the system. The Legislature also concurs with the board's finding that direct relief from contributions in this time of fiscal stress is for the exclusive benefit of the members and retired members of the system." (*Ibid.*)

Under chapter 330 former section 20203 was amended to provide in pertinent part: "At the end of each fiscal year, the amount in the reserve against deficiencies which exceeds 1 percent of the total assets of the system shall be credited to other accounts as prescribed by this part." (Stats. 1982, ch. 330, § 14.) Chapter 330 also enacted several notable statutes governing PERS. Section 20131.1 requires the PERS Board to credit employer contributions with interest at the current net earnings rate. (Stats. 1982, ch. 330, § 12.) Section 21232 requires the board to transfer $130 million from the reserve for deficiencies to a special account to pay Boatwright benefits for an additional two years. (Stats. 1982, ch. 330, § 29.) The Boatwright benefit has been extended subsequently with pourover funding from the Investment Dividend Disbursement Account, which we next explain. (Stats. 1984, ch. 671, § 1; Stats. 1985, ch. 1495, § 3; Stats. 1988, ch. 1356, § 3.)

Section 21235 requires that the PERS Board establish an Investment Dividend Disbursement Account (Investment Dividend Account) for the purpose of increasing retirement allowances to an amount equal to 75 percent of their original purchasing power. (Stats. 1982, ch. 330, § 30.) The Investment Dividend Account is funded by the residue from earnings after deducting system administration costs, funding the reserve against deficiencies to 1 percent of total assets, and crediting interest to member accounts. (Stats. 1982, ch. 330, § 30.) Member contributions are credited at the current actuarial interest rate. The PERS Board is required to notify recipients of this benefit that "the increases are not cumulative, not part of the base retirement allowance, and may be available for only a limited period of time and that the board may discontinue the increases." (Stats. 1982, ch. 330, § 30.) Chapter 330 also provides that the authorization to pay increased allowances from the Investment Dividend Account under section 21235 was to expire on January 1, 1989. (Stats. 1982, ch. 330, § 30.)

C. *Chapter 1356 of the Statutes of 1988*

Statutes of 1988, chapter 1356 reconfigured the Investment Dividend Account program. Section 20203 was amended to reduce the maximum size of the reserve against deficiencies to 0.30 percent of system assets. The Investment Dividend Account was set at a fixed amount and drew interest at the rate used to credit retired member reserves. (§ 21237.) The remaining funds available under the allocation formula of section 21235 were retained in so called Purchasing Power Accounts. (§ 21237.) The funds in these accounts were used to pay Boatwright benefits and other purchasing power benefits. (§§ 21235-21236.) The Investment Dividend Account supplemented the Purchasing Power Accounts to pay these benefits. (§ 21235.)

Chapter 1356 also established the Extraordinary Performance Dividend Account (Extraordinary Perform-

ance Account). Section 21238 permitted the PERS Board, in years in which the 75 percent of purchasing power goal was met by payments from the Purchasing Power Accounts, to raise pensions to a higher common minimum purchasing power level. The first payment from the Extraordinary Performance Account occurred in January 1991 and under the policies adopted by the PERS Board brought all allowances up to 80 percent of original purchasing power. Payments under this program were paid by a separate warrant and recipients were notified "that the payments are not cumulative, not part of the base retirement allowance, and may be available only as a result of extraordinary investment returns to the system." (§ 21238.)

The Extraordinary Performance Account was funded by pourover funds from the Purchasing Power Accounts consisting of the amount, not to exceed the amount disbursed in the preceding fiscal year, remaining after disbursements were credited to retired member accounts from any funds in excess of those disbursed pursuant to sections 21235 and 21236 for Boatwright and purchasing power allowances in the four preceding years. (§ 21237, subd. (b).) Petitioners concede that the funds, credited to refund member accounts, became employer assets, since they were available to make up part of the ordinary retirement allowance.

D. *Chapter 83 of the Statutes of 1991*

That brings us to Chapter 83 of the Statutes of 1991, which is the subject of Petitioners' challenge. This enactment repeals the statutes providing for the Boatwright benefit, the 75 percent of purchasing power floor, and the Extraordinary Performance Account benefit (collectively former supplemental Colas). (Stats. 1991, ch. 83, §§ 35, 37, 39, 40.) The funds allocated for these benefits are to be used to "reduce employer contributions in fiscal year 1991-92 and subsequent fiscal years until those amounts are depleted." (§ 20131.01.)

In place of the repealed programs section 21235.5 enacts an alternative Cola program, as follows.

> "(a) On an annual basis, the board shall transfer the lesser of: (1) the amount necessary to increase all monthly allowances paid by the system to 75 percent of the purchasing power of the initial monthly allowances; or (2) up to 1.1 percent of the net earnings on member contributions, as determined by Section 20132.6, to a supplemental account.
>
> "(b) The funds so transferred to the supplemental account shall be utilized to increase all monthly allowances paid by the system up to a maximum of 75 percent of the purchasing power, as determined by the actuary, of the initial monthly allowances that were received by every retired person or survivor or beneficiary of a state, school or local member or retired person who was eligible to receive any allowance at the end of each fiscal year. Funds remaining in the account after the payment of benefits under this section shall be transferred to the employer accounts. (Stats. 1991, ch. 83, § 36.)

Chapter 83 also transfers many of the actuarial duties previously assigned to the PERS Board to the Actuary. Section 20006 provides:

> "(a) 'Actuary' means an individual or firm practicing as an enrolled consulting actuary appointed by the Governor under contract with the Governor's Office. The contract shall not be subject to any provisions of law relating to competitive bidding. The contract shall be for a fixed period of time not to exceed three years as determined by the Governor. The compensation paid to the actuary and other necessary employees of the actuary shall be fixed by the contract. The actuary under contract with the Governor's Office pursuant to this section may not be awarded a successive contract. All costs of the con-

tract for the actuary shall be paid from the retirement fund on an annual basis. In carrying out duties under this part, the actuary shall be deemed to succeed to and assume the fiduciary obligations pertaining to actuarial determinations previously held by members of the board, including, but not limited to, those set forth in Section 17 of Article XVI of the California Constitution.

"(b) The Governor shall submit the name of the actuary to each house of the Legislature. The actuary shall commence serving in office on the day after receipt of confirmation by both houses of the Legislature. However, the appointment shall become effective and be deemed confirmed the 61st calendar day after the submission of the nomination unless a majority of either house affirmatively rejects the nomination. If the 60-day period ends during a recess of the Legislature, the period is extended to the sixth day following the date on which the Legislature reconvenes." (Stats. 1991, ch. 83, § 5.)

Under the statutes enacted by Chapter 83 the Actuary, among other things, values the liabilities and assets of PERS (§ 20006.1), adopts the annual interest rate and the actuarial interest rate (§§ 20026.1, 20026.2), and determines the employer contribution rates (§ 20750.905).

Additional facts will be introduced at appropriate points in the discussion of the contentions made by the parties.

DISCUSSION

Introduction

We address the most forceful of the arguments advanced by Petitioners and their allies, the PERS Board and the numerous amici, without separate attribution.[2]

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[2] Petitioners have expressly adopted and incorporated the arguments of their allies.

In the voluminous briefings there are numerous arguments which we will not relate or discuss. Many of them are addressed to the wisdom of Chapter 83, a topic outside our purview. (See, e.g., *Valdes* v. *Cory*, *supra*, 139 Cal.App.3d at p. 780.) Other arguments are simply overtaken or outflanked by resolution of the matters which we do discuss or do not warrant discussion because they are too fragmentary or obscure. (See 9 Witkin, Cal. Procedure (3d ed. 1985) Appeal, § 479.)

Petitioners and their allies challenge the validity of the repeal of the former supplemental Cola programs and the reallocation of the monies made available thereby to offset the payment obligations of PERS employers. They claim that all members of the retirement system have contractual rights to the benefits of the repealed programs which have been unconstitutionally impaired by their repeal and replacement by a Cola program which does not provide comparable benefits. Failing that argument they claim that the monies which funded the repealed programs are held in trust for PERS members and cannot be used to offset the obligations of PERS employers. They also challenge the transfer of the PERS Board actuarial duties to an actuary selected by the Governor. We will answer these claims in the following ways.

We begin by assuming that the statutes which created the former supplemental Colas establish contractual rights which may not be altered except by replacement with a program establishing comparable benefits. Our assumption does not extend to PERS members who retired prior to the effective dates of the former programs because they did not exchange their labors for the benefits created after retirement and for that reason gained no vested contractual rights to them. This circumstance affects the comparability of the new Cola program because the former employees are the principal beneficiaries of the repealed programs.

A significant feature of the repealed programs is that their benefits were limited by the amounts in the fund out of which they were to be paid. If the funds declined so did the benefits which they funded. A significant provision of Chapter 83 is that it creates a "second tier" of pension benefits for new employees, who do not make member contributions. The validity of that provision determines whether the new Cola program provides benefits which are comparable to those afforded under the repealed supplemental Cola programs. Since the repealed and new Cola programs must be similarly judged the benefits provided by the repealed programs must be viewed as if modified by the creation of a second tier of non-contributory employees. So viewed, the fund out of which the former supplemental Colas would have been paid would have ceased to grow and would have been largely consumed by payments to retired members lacking vested contractual rights to the benefits paid by the fund. We determine that the Legislature could validly amend the statutes governing PERS by the addition of a second tier of noncontributory employees, the effect of which would have been to erase the benefits to members with vested rights in the former supplemental Cola programs. For that reason the new Cola program provides an obvious new advantage for such members, actual benefits for the theoretical but illusory higher benefits under the repealed programs.

Petitioners and their allies nonetheless argue that because the fund made available by the repeal of the former supplemental Cola programs is held in trust for the benefit of PERS members it may not be used to defray employer contributions which otherwise would be required. We conclude that although the fund must be committed to the payment of PERS trust benefits, since the repeal of the former supplemental Cola programs makes available monies not previously counted toward the actuarial soundness of the trust fund, they may be counted so as to offset PERS employer obligations until employer

contributions are again required for actuarial soundness. Counted in this manner the funds remain committed to the payment of PERS trust benefits.

Petitioners and their allies claim that the provisions of section 20006, which transfer the PERS Board actuarial duties to an actuary selected by the Governor, violate article XVI, section 17 of the California Constitution which declares that PERS assets are trust assets. They assert, and we assume, that this provision constitutionalizes the law of trusts. Section 20006 provides that the Actuary must "assume the fiduciary obligations . . . previously held by members of the [PERS] board, including . . . those set forth in Section 17 of Article XVI of the California Constitution." (§ 20006, subd. (a).) Because Petitioners challenge the validity of section 20006 on its face we are constrained by the limited scope of judicial review appropriate to such a challenge to rule out conjecture predicated upon hypothetical applications of the statute. We will conclude that there is nothing in section 20006 which facially precludes the Actuary from complying with its direction to comply with the "fiduciary obligations [imposed by] Section 17 of Article XVI of the California Constitution."

I

The Repeal of the Former Supplemental Cola Statutes Does Not Impair Vested Rights of Contract

Petitioners challenge the reallocation of the funds committed to the former supplemental Cola programs to defray PERS employer funding obligations. We first address the predicate contention that the repeal of the statutes establishing the former supplemental Cola programs unconstitutionally impairs rights of contract. If that contention is successful the remaining claims are moot. If the repeal of these statutes is invalid the funds allocated to the former supplemental Colas are not available to defray the employer funding obligations.

The basic doctrines governing pension rights are set out in the following passage from Betts v. Board of Administration (1978) 21 Cal.3d 859.

> "A public employee's pension constitutes an element of compensation, and a vested contractual right to pension benefits accrues upon acceptance of employment. Such a pension right may not be destroyed, once vested, without impairing a contractual obligation of the employing public entity. The employee does not obtain, prior to retirement, any absolute right to fixed or specific benefits, and only to a 'substantial or reasonable pension' . . . .
>
> " . . . 'An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages.' (*Id.* at pp. 863-864, citations and italics omitted; also see Annot., Vested Right of Pensioner to Pension (1957) 52 A.L.R.2d 437, 444-450 for a synopsis of California case law.)

A. *Only Persons Employed After January 1, 1989 Could Have Vested Rights to Former Cola Benefits*

Petitioners and the Governor join issue on the question whether the former supplemental Colas vest contract rights to pension benefits in *anyone* within the meaning of *Betts*. The Governor claims that the peculiar character of these programs distinguishes them from the

statutory entitlements which were the subject of the cases in which the vesting rule developed. He relies upon two primary considerations: (1) that the benefits are expressly conditioned upon the sufficiency of a fund for which there is no promise of actuarial soundness and, (2) that the former supplemental Cola statutes contain admonishments to recipients that future benefit payments are not assured. Petitioners reply that the fact that benefits are subject to a condition only limits vesting to the circumstances addressed by the condition and that the admonitions only inform the beneficiaries of the condition.

At the outset it is useful to resolve a subordinate vesting question, whether members who ceased employment prior to the enactment of the former supplemental Colas have vested rights in their continuance. Petitioners' initial arguments fuse the interests of these members (former employees) with those employed after their effective dates (present employees).

The contractual basis of a pension right is the exchange of an employee's services for the pension right offered by the statute. (See, e.g., California State Teachers Association v. Cory, supra, 155 Cal.App.3d at p. 506). A member whose employment terminated before enactment of a statute offering additional benefits does not exchange services for the right to the benefits. We asked the parties whether these former employees have vested rights.

Petitioners first claim that once new pension benefits are made applicable to retired persons they may not be taken away, relying upon Terry v. City of Berkeley (1953) 41 Cal.2d 698, 702 and Wallace v. City of Fresno (1954) 42 Cal.2d 180. The cases are inapposite. *Terry* did not address the question. It concerned the construction of ambiguous language in a pension ordinance applicable at the time the plaintiff retired for a physical disability incurred in the line of duty. (*Id.* at p. 699.)

The court construed the language in favor of the retiree, holding that an attempt to cure the ambiguity by an amendment of the ordinance "more than four years after the plaintiff retired" was ineffectual. (*Id.* at pp. 702-703.) For the same reason *Wallace* is inapposite. It addressed the reasonableness-"of an amendment [to the employee's pension plan], made before [the] employee is eligible to retire, which provides for termination of pension rights if he is convicted of a felony after retirement." (*Id.* at p. 184.)

Petitioners' remaining claim of direct support rests on Olson v. Cory (1980) 27 Cal.3d 532. At issue was the validity of the repeal of a statute which resulted in a full Cola for judicial pensioners who had retired before the statute was enacted. The court held that the repeal of the statute was invalid regardless whether the pensioners had earned a vested right in the full Cola by service after its enactment. Petitioners conclude therefrom that benefits given retirees after retirement cannot be reduced regardless whether they earned vested rights to them. Petitioners misread the case.

The holding is predicated upon a vested contract right which the retired member did hold. The right was earned not by service under the Cola statute but by service under a statute which measured retirement rights as a percentage of the salary of the judge's successor in office. If the successor had vested rights to a full cost of living adjustment in salary by service after its enactment the pensioner obtained a vested right to a percentage of that salary by virtue of the statute in effect at the time of retirement. The court said: "*Contractually*, each judicial pensioner is entitled to some fixed percentage of the salary payable to the [successor] judge . . . . The resolution of pensioner *vested* rights, then, is dependent on the foregoing resolution of [the successor] judges' vested rights . . . ." (Olson v. Cory, supra, 27 Cal.3d at pp. 541-542, emphasis added.) Since the successor judges earned

vested rights to the salary called for under the full Cola salary statute, the pensioners' vested contract right to a percentage of that salary rendered its repeal invalid as to them.

Olson v. *Cory* does not aid Petitioners because the pension rights of PERS members are not tied to their successors' salary. For that reason employees who ended their service prior to the enactment of the former supplemental Cola statutes have no vested right which could be impaired by their repeal. (See 27 Cal.3d at p. 542; Pasadena Police Officers Assn. v. City of Pasadena (1983) 147 Cal.App.3d 695, 706; York Paid Firemens Pension Fund Board of York City v. Lindsey (Pa. Cmwlth. 1980) 415 A.2d 441.)

That brings us to Petitioners' claim that former employees obtained a vested right to continuance of the former supplemental Colas because they exchanged another vested right for them. Petitioners suggest that this is a case like *Pasadena Police Officers Assn.*, *supra*, which held that employees were entitled to the continuation of a Cola based upon such an exchange. In that case the retirees had earned a contractually vested right to a fixed pension which could not be reduced. A post employment amendment of the pension ordinance offered these retired employees an option to exchange that vested right for a pension measured by a Cola having the potential of increasing or decreasing the pension by a cost of living adjustment. The court held that retirees who elected the Cola provision were protected from repeal of the amendment because their post employment election to exchange benefits created a contract that could not be impaired.

Petitioners argue that former state employees are in an analogous situation because the statutes establishing the former supplemental Colas funded them by reduction of the reserve against deficiencies from 1 percent of

PERS assets to 0.30 percent of PERS assets. They claim that the former employees had a vested contract right to a reserve account of 1 percent of PERS assets under our holding in *Valdes* v. *Cory* and suggest that the only manner in which the reduction of the reserve account could have passed constitutional muster is on the theory the pension rights were reasonably modified pursuant to the criteria in *Betts*. They claim that the former supplemental Colas were the comparable new advantage required to offset the disadvantage of reduction of the reserve account.

The analogy to *Pasadena Police Officers Assn.* is inapposite. The former employees made no election (acceptance) of an alternative pension right offered by the employer. No new contract was formed by an exchange. Their claim of right must be founded upon the antecedent contract, entered into prior to retirement, or they have none. As we will show (§ *II*, *post.*, pp. 34-39 [typed opinion]), *Valdes* does not hold that there is a vested contract right to a reserve account of 1 percent of system assets. Moreover, retirees, unlike employees, are not subject to the reasonable modification doctrine. (See e.g., *Terry*, 41 Cal.2d at pp. 702-703; *Betts*, 21 Cal.3d at pp. 864-865.) If their contracts had been impaired by the reduction of the reserve account their remedy was a timely action to avert or halt the impairment.

The only arguable claims of vested contractual rights pertain to present employees, members employed after Statutes of 1988, chapter 1356 reconfigured the Investment Dividend Account program. Prior to that enactment the former supplemental Cola programs were subject to expiration by sunset provisions. (See, e.g., Stats. 1982, ch. 330, § 29.) The elapsed period between these enactments and their sunset dates are such that employees who worked under them would not have reached eligibility for payment of supplemental Cola benefits prior to their expiration.

B. *Reasonable Modification*

We need not reach the issue whether members employed after January 1, 1989, are entitled to vested contractual rights in the former supplemental Cola programs. Under California law an " 'employee's vested contractual pension rights may be modified prior to retirement [provided that the] modifications must be reasonable . . . .' " (*Betts, supra*, 21 Cal.3d at p. 864.) Because it poses novel constitutional questions, the resolution of the question of vested rights is more problematic than resolution of the question whether Chapter 83 is a reasonable modification of the prior supplemental Cola programs. If we resolved the vesting question in favor of Petitioners we would nonetheless have to address this latter question. Since constitutional adjudication is eschewed where possible (E.g., Cumero v. Public Employment Relations Bd. (1989) 49 Cal.3d 575, 586) we will proceed to the question of reasonable modification, assuming for the sake of discussion that Petitioners would prevail on the vesting question as to persons employed after January 1, 1989.

1. *The Changes In The Supplemental Colas Bear a Material Relation to the Theory of PERS*

Under *Betts* a modification of a vested pension right is reasonable only if it "bear[s] some material relation to the theory of a pension system and its successful operation, and changes in [it] which result in disadvantage to employees [are] accompanied by comparable new advantages." (21 Cal.3d at pp. 864-865.)

Petitioners first argue that the new supplemental Cola program lacks the requisite relation to the theory of the pension system and its successful operation because the purpose of the enactment is to alleviate a state budget deficit. The Governor argues that the changes provide a more certain source of long term funding for the supplemental Cola benefits as well as alleviating a deficit.

Petitioners suggest that the material relation requirement renders changes made with a purpose of saving the public employer money invalid per se. We disagree.

The saving of public employer money is not an illicit purpose if changes in the pension program are accompanied by comparable new advantages to the employee. If that were not the case the reasonable modification doctrine would add little flexibility to the administration of the public pension systems. The "material relation" requirement fulfills "the purpose of keeping the pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system . . . ." (See Wallace v. City of Fresno, supra, 42 Cal.2d at pp. 184-185.)

The case law which applies the "material relation" requirement is sparse. *Wallace* held that an amendment which terminated all pension rights of a pensioner upon conviction of a felony after retirement did not satisfy that requirement. (42 Cal.2d at p. 185.) "[T]he change was designed to benefit the city and . . . to meet the objections of taxpayers who would be opposed to contributing funds for the maintenance of a pensioner who had been convicted of a felony." (*Ibid.*) In Allen v. City of Long Beach (1955) 45 Cal.2d 128, 133, it was held that amendments which increased the employee contribution rate, providing for a fixed pension and requiring a contribution from employees returning from military service, did not bear a relation to the functioning and integrity of the pension system. The City did not claim that the changes were necessary to preserve or protect the pension program or that otherwise it would have difficulty in meeting its pension obligations. (*Ibid.*) It claimed that newer employees, not eligible for the original pension rights, were disgruntled and that to remedy that condition it wished to equalize the compensation of the two groups of employees. (*Ibid.*)

Wallace and *Allen* show that considerations external to the functioning of the pension system, such as increased

taxpayer hostility to felons or jealousy of employees not covered by the system will not justify a change. The justification must relate to considerations internal to the pension system, e.g., its preservation or protection or the advancement of the ability of the employer to meet its pension obligations. Changes made to effect economies and save the employer money do "bear some material relation to the theory of a pension system and its successful operation . . . ." (Betts v. Bd. of Administration, supra, 21 Cal.3d at p. 864.) That is not to say that a purpose to save the employer money is a sufficient justification for change. The change must be otherwise lawful and must provide comparable advantages to the employees whose contract rights are modified. We hold only that the monetary objective will not invalidate a modification which is otherwise valid.

2. *Unless the Second Tier Provision is Invalid the New Supplemental Cola Provides A Comparable Advantage In Lieu of the Disadvantage of Lower Maximum Benefits*

Petitioners locate the disadvantage in the lowered purchasing power maximums for the new supplemental Cola benefits under section 21235.5. As we next show, the claim fails unless the provision of Chapter 83 which requires that certain state employees hired after the effective date of the statute be placed in a noncontributory pension plan (mandatory second tier) is invalid.

Under the former supplemental Cola programs retirees eligible for Boatwright benefits could receive more than 75 percent of the original purchasing power of their pensions and all retirees could receive more than that level under the Extraordinary Performance Account program. Under new section 21235.5 the maximum level of purchasing power protection is 75 percent. Petitioners originally argued that this is a disadvantage for which

there is no offsetting comparable advantage. The Governor replied that comparability does not require point by point equality and suggested that the potential for greater benefits under the repealed statutes is offset by the greater assurance of funding under section 21235.5.

The Governor adduced an independent actuarial report [the Foster-Higgins report], provided to PERS on January 15, 1991, under a contract authorized by former section 20234.[3] He argues that it shows that the accumulated former supplemental Cola funds would have been exhausted in about a decade and that the annual funding mechanism for that program is less reliable and productive than the annual funding mechanism under the new supplemental Cola. The Petitioners challenge both the interpretation and methodology of the report.

The Petitioners adduced expert actuarial opinion testimony supporting the conclusion that if the former supplemental Cola program had continued and had been operated under past policies, its annual funding mechanism would have been more productive than the funding mechanism under the new supplemental Cola. The Governor replied with contrary expert actuarial opinion.

As we have shown, the reasonableness of the modification must be viewed from the vantage point of persons employed on or after January 1, 1989. That has significant consequences for Petitioners' original arguments.

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[3] Former section 20234 (Stats. 1982, ch. 1496, § 5; repealed Stats. 1991, ch. 83, § 26) is as follows. "The board shall annually contract with an independent actuary to analyze and comment on the application of generally accepted actuarial practices to the actuarial assumptions utilized by the board during the preceding fiscal year and the effect of the benefit provided by Section 21235 on employer contribution rates. [¶] A copy of the report shall be filed with each house of the Legislature, the chairman of each affected policy committee, and the Governor at the same time as the report required by Section 20136."

Boatwright benefits were available only to persons whose employment terminated prior to the enactment of the program. Therefore no one has vested rights in it.

The loss of the potentially higher level of benefits under the Extraordinary Performance Account program is a disadvantage, but that potential must be evaluated by its actuarial consequences. A person employed on January 1, 1989, was not entitled to receive Extraordinary Performance Account benefits (as the program was administered by PERS) until retirement and erosion of the pension's value to 80 percent of its original purchasing power. That would not occur until nine years after the date of retirement, assuming a 5 per cent inflation rate and a basic Cola of 2 percent. For that reason the comparability of the new supplemental Colas to those under the Extraordinary Performance Account must be gauged by the benefits which would accrue for the period beginning in 1998 and extending over the likely duration of their receipt.

In light of this measure of comparability and the conflicting opinion testimony we asked the parties to compare the projected benefits of a typical, hypothetical present employee under the former and new supplemental Cola programs. Because Chapter 83 has a mandatory second tier under which new employees would make no member contributions we asked the parties to factor the absence of such contributions into their calculations of projected benefits under *both* supplemental Cola programs.

The parties adduced evidence in response to our request. The Governor adduced evidence of projected benefits predicated upon a mandatory second tier. This evidence shows that the projected new benefits are likely to be equivalent to or greater than those available under the former program. The Petitioners declined to compare projected benefits on the assumption of a mandatory second tier applicable to the former supplemental

Cola programs.[4] They argue that the comparison would be misleading. "The very reason that the [new supplemental Cola] Program fails, when compared to the [former supplemental Cola] Program, is that the [new supplemental Cola] Program is accompanied by a mandatory second tier, while the [former supplemental Cola] program was not."

It is apparent that Petitioners' claim of unreasonable modification succeeds only if the mandatory second tier is invalid if applied to the former supplemental Cola programs. Unless the second tier is invalid the new supplemental Cola program provides an obvious new advantage for present employees, actual benefits for the theoretical but illusory higher Extraordinary Performance Account benefits. Accordingly, Petitioners' contention that the repeal of the former supplemental Colas is invalid fails unless the addition of a mandatory second tier provision is infirm.

3. *A Mandatory Second Tier Provision Does Not Unconstitutionally Impair Rights of Contract*

Petitioners, apprehending the foregoing implication, now contend that a mandatory second tier provision impairs vested contract rights under the former supplemental Cola statutes because of its derivative impact upon benefits under those programs. They argue, without benefit of legal support, that since a mandatory second tier provision would ultimately cause benefits under the former supplemental Colas to fall short of the maximum

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[4] The PERS Board also provided sketchy evidence regarding the comparability of benefits in response to our request. That evidence tends to show that "[a]s long as there are sufficient funds to pay [former supplemental Cola] benefits, those payments are larger than the payments provided by [Chapter 83]." However, that begs the question of the effect of a second tier upon the continued availability of funds to pay the supplemental Cola benefits. The PERS Board failed to address that question.

levels called for "it destroys the vested [former supplemental Cola] benefit." The argument assumes the answer. The appropriate question is whether there is a vested contract right under the former supplemental Cola statutes to continued contributions by new employees which is impaired by a statute which places new employees in a noncontributory pension program.

Unlike most statutes providing for pension benefits the former supplemental Cola statutes offer benefits which are expressly predicated upon the availability of moneys in the fund from which they are to be drawn. (§§ 21235-21236; Stats. 1988, ch. 1356.) There is no right to their payment if the fund is insufficient to fund the benefits. (See Bellus v. City of Eureka (1968) 69 Cal.2d 336, 352.) The question then arises whether the statutory scheme establishing the former supplemental Colas contains an express or implied promise that the Legislature will not change the nature of the pension system as to future employees if that would have a detrimental impact on the fund from which the former supplemental Colas were to be paid. (See California Teacher's Association v. Cory, supra, 155 Cal.App.3d at pp. 504-506.)

There is no such promise in the statutory scheme either express or implied. The express dependence of the former supplemental Cola benefits upon the prescribed funding scheme belies an assurance that the benefit targets are promises. A promise not to change the character of a pension program as to new employees is a fundamental constraint on the freedom of action of the Legislature. There is no such promise expressed in the statutes and we will not imply one. "Future employees do not have a vested right in any particular pension plan (*Estes* v. *City of Richmond* [(1967) 249 Cal.App.2d 538], pp. 544-545.) And, although active and retired members have a vested right to a pension, they do not have a vested right to control the administration of the plan which

provides for the payment of pensions." (Whitmire v. City of Eureka (1972) 29 Cal.App.3d 28, 34.)

This court implied contractual obligations in *Valdes* v. *Cory* and *California Teacher's Association* v. *Cory* which constrained the administration of PERS and the Teachers' Retirement Fund. We did so on the strength of assurances to be found in the language of the governing statutes. In both cases the statutes showed a "commitment to permanency" of funding of "critical importance" to the "underlying contractual promise to pay the pensions . . . ." (*California Teacher's Assoc.* v. *Cory*, *supra*, 155 Cal.App.3d at p. 506.) We noted that the implication of suspension of legislative control must be "unmistakable." (*Id.* at p. 509.) The implication Petitioners urge here falls short of that requirement.

Had the mandatory second tier been enacted independently of the new Cola program its impact upon the funding of the former supplemental Colas would furnish no cause of action. For that reason the mandatory second tier must be taken into account in evaluating the comparative value of the new supplemental Cola. As we have explained, that renders nonmeritorious Petitioners' contention that the new supplemental Cola is not a reasonable modification as to the employees who may have vested contract rights.

The repeal of the former supplemental Cola statutes effected by Chapter 83 is valid.

II

The Use of Funds From the Former Supplemental Cola Programs to Offset Employer Contributions Does Not Impair Funding Rights Identified in Valdes v. Cory

Petitioners contend that in any event the use of the fund made available by the repeal of the former supplemental Cola programs to defray employer contributions

to the PERS fund impairs vested contract rights to funding which we identified in *Valdes* v. *Cory*, *supra*.

What we said in *Valdes* v. *Cory*, to which Petitioners point, rests upon "the nature of the reserve against deficiencies." (139 Cal.App.3d at p. 788.) That fund is statutorily allocated to meet contingencies that could impair the actuarial soundness of the PERS fund. In this case, the *valid* repeal of the former supplemental Cola programs has created a unique fund of a critically different nature. These monies were not previously counted toward the actuarial soundness of PERS, were not reserved to underwrite the actuarial soundness of the basic pension benefits, and are not now tied to the provision of any special benefits required to be paid.[5] Shorn of its relation to the benefits provided under the former supplemental Cola programs, the fund is available to back the actuarial soundness of the PERS system and may be applied to offset the employer contributions that would otherwise be required to that end.

Petitioners rely upon the portion of *Valdes* v. *Cory* which rejects the argument that the state had not defaulted in its continuing obligation to make monthly payments to the PERS fund by merely changing the source of the contributions from the general fund to the PERS reserve against deficiencies. (139 Cal.App.3d at pp. 787-

[5] For this reason petitioners' argument that permitting consideration of the former supplemental Cola funds to offset employer contributions will establish a precedent for future expropriation of other PERS funds is ill-founded. Petitioners' alarm is apparently based upon the addition of the following underlined language in an amendment of section 20203.3. "Notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of the system, investments for the benefit of the system, *the reduction of employer contributions*, and the provision of benefits to the members and retired members of the system and their survivors and beneficiaries." Whatever the purpose of the amendment, it cannot overrule *Valdes* v. *Cory*.

790.) In this passage we considered the argument of the Director of Finance that the State met its continuing obligation to make monthly payments from the PERS reserve against deficiencies. (*Id.* at p. 787.) We rejected the argument on the ground that it "misconceives the nature of the reserve against deficiencies." (*Id.* at p. 788.)

Petitioners submit that the passage forbids the use of any PERS fund of whatever nature to offset an otherwise required employer contribution. To the extent that the language in *Valdes* v. *Cory* is susceptible to this reading it addresses matters not in issue in that case. The preservation of the actuarial soundness of PERS entails a comparison of the funds available to meet its financial obligations with the obligations. If for some lawful reason the existing PERS funds are demonstrably sufficient for actuarial soundness without the state's periodic contribution, the Legislature may forego the contribution without violating the holding in *Valdes* v. *Cory*. (See 139 Cal. App.3d at p. 787.)

Funds may be counted only once to determine the amount of the employer contribution necessary to keep the system in actuarial trim. In keeping with *Valdes* v. *Cory*, funds in a reserve account which are dedicated to backstopping the integrity of the system against unexpected contingencies may not be used to offset the employers' obligations to contribute to the actuarial soundness of the system unless there is a predicate showing that their use will not undermine the financial integrity of the system.

Petitioners claim that *Valdes* v. *Cory* prohibits the offset here because, as in that case, Chapter 83 was enacted "without any *actuarial* input or recommendation from the Board, as directed by former section 20750.9, that contributions could or should be eliminated." The argument is unpersuasive because, unlike *Valdes* v. *Cory*,

an appropriate actuarial predicate existed prior to the enactment of Chapter 83.

In *Valdes* v. *Cory* we discerned in the statutes which imposed actuarial duties upon the PERS Board a requirement that periodic employer contributions not be altered "absent actuarial input from the board in a timely manner." (139 Cal.App.3d at p. 787.) The evidence we considered did not show whether the transfer of funds from the reserve against deficiencies would undermine the security of members' rights to receive vested benefits.[6] The failure of the State to meet its burden to demonstrate the absence of such an impact accounts for our rejection of its arguments, both those considered in the opinion and those rejected without discussion.

In this case, the monies which initially funded the former supplemental Colas were obtained from the reserve against deficiencies pursuant to a finding by the PERS Board that the money could be so allocated *without* jeopardizing the actuarial soundness of the system. "In enacting this act, the Legislature agrees with the findings of the chief actuary and the board, who, on June 16, 1982, determined that funds in the reserve for deficiencies may be allocated from the reserve without jeopardizing the actuarial soundness of the system."

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[6] At the outset of *Valdes* v. *Cory* we ascertained that PERS is intended to be maintained on a sound actuarial basis and that such a transfer of funds impaired the member's contract rights in such a fund. (139 Cal.App.3d at pp. 785-786.) We then said: "[h]aving delivered ourselves of this dictum we confess that the record before us is woefully incomplete and inadequate as a basis upon which to determine whether the disputed provisions of chapter 115 do in fact impair the actuarial soundness of the PERS. [Citations.] [¶] We ***therefore*** turn to consideration of the contention that the state has a statutorily created contractual obligation, impaired by operation of chapter 115, to make systematic, substantial monthly contributions to the PERS fund in order to fund pension benefits as liability therefor is incurred." (*Id.* at p. 786, emphasis added.) The subsequent analysis rests upon this state of the record.

(Stats. 1982, ch. 330, § 1.) The subsequent allocations of earnings on employee contributions to the former supplemental Cola funds were accomplished, with the apparent acquiescence of the PERS Board, pursuant to statutes which were not challenged as actuarially unsound when enacted.

The Legislature was entitled to view this allocation of monies to fund the former supplemental Colas as not undermining the security of members' rights to receive their basic pension benefits. Unlike the reserve against deficiencies the former supplemental Cola funds were not allocated to backstop the basic pension benefit promises. Since the funds were not counted toward the maintenance of the actuarial soundness of the PERS fund or allocated to cover contingencies that could impair actuarial soundness they are logically immaterial to actuarial soundness. Their use to offset employer contributions that would otherwise be required to be made is not prohibited by the holding in *Valdes* v. *Cory*.

III

The Use of Former Supplemental Cola Funds To Reduce Employer Contributions Otherwise Required Does Not Unconstitutionally Invade the PERS Trust

Petitioners contend that the use of the former supplemental Cola funds to reduce employer contributions violates California Constitution, article XVI, section 17.[7]

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[7] California Constitution, article XVI, section 17, in pertinent part is as follows.

"....

"Notwithstanding provisions to the contrary in this section and Section 6 of Article XVI, the Legislature may authorize the investment of moneys of any public pension or retirement system, subject to all of the following:

"(a) The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and

The thrust of the argument is that since the assets of the system are declared in that section to be "trust funds" which "shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system" they cannot be used to defray the employers' funding obligation. The answer to this argument is that the money has not been diverted from the system and is to be used for the purposes authorized by the California Constitution.[8]

The language of article XVI, section 17, upon which Petitioners rely, was enacted by an amendment of June 5, 1984. The ballot arguments of the proponents of the measure asserted that the measure would "give public pension assets full constitutional protection as trust funds" and "guarantee[] that neither the Governor nor future Legislatures will ever be able to use this money for other purposes." (Ballot Pamp., argument in favor of Proposition 21 as presented to the voters, Prim. Elec. (June 5, 1984) p. 26.) The arguments also assert that under the measure "the *only purpose* for which these trust assets

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their beneficiaries and defraying reasonable expenses of administering the system.

"(b) The fiduciary of the public pension or retirement system shall discharge his or her duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system."

[8] We note parenthetically that the parties argue over the application of subdivision (b) of article XVI, section 17, the topic of a recent opinion of this court in City of Sacramento v. Public Employees Retirement System (1991) 229 Cal.App.3d 1470, 1492-1494. The argument is a digression since the subdivision pertains to the duties of the fiduciary of the public pension or retirement system. This refers to the duties of the trustees and not, save perhaps derivatively when legislating upon that topic, to the duties of the Legislature which are in issue here.

can be used is the delivery of retirement benefits" and that it "[e]nacts the *sole and exclusive purpose rule* which imposes on fund trustees the legal obligation to perform their duties *solely* in the interest of plan beneficiaries." (*Ibid.*, orig. emphasis.)

Neither the trust provisions of article XVI, section 17, nor the statements of its proponents in the ballot argument apply to the action challenged here. The use of the former supplemental Cola funds to reduce the employer contributions otherwise necessary to keep the PERS fund in actuarial trim does not invade the PERS trust. (Cf., e.g., Stats. 1982, ch. 330, § 1, quoted, *ante*, [typed opinion p. 9].) The funds, in the words of the California Constitution, continue to be "held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." The funds, in the words of the ballot argument, will only be used for "the delivery of retirement benefits." They remain PERS assets until they are paid to PERS members or beneficiaries or to defray the costs of administration of the system.

The use of these funds to meet the employers' continuing funding obligation is no more proscribed by article XVI, section 17, than is the use of earnings attributable to the employer accounts of the PERS fund for the same purpose. The contract right to periodic employer funding can only be determined by considering the value of the PERS assets that are available to defray its legal obligations. If this use were barred by the exclusive purpose language of subdivision (a) of article XVI, section 17, the funding obligation would be rendered unintelligible.

For these reasons the contention that the use of the former supplemental Cola funds to reduce employer contributions violates California Constitution, article XVI, section 17, is not meritorious.

IV

The Assignment of PERS Actuarial Duties to an Outside Actuary Is not Unconstitutional

A. *Appointment of the Actuary by the Governor Does not Present an Intolerable Conflict of Interest*

Petitioners challenge other provisions of Chapter 83, which transfer actuarial duties from the PERS Board to an actuary appointed by the Governor, as violating article XVI, section 17 of the California Constitution. As related, it provides that the PERS assets "are trust funds" and the "fiduciary of the . . . system shall discharge his or her duties . . . solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system." Petitioners suggest that these provisions constitutionalize the law of trusts and under that law the Actuary cannot qualify as a fiduciary because Chapter 83 places the Actuary under the control of the Governor and subject thereby to an intolerable conflict of interest precluding a fiduciary relationship with beneficiaries of the PERS trust fund.

Since Petitioners tender a facial challenge to the constitutionality of Chapter 83 we must test the legislation by the fair reach of its terms, avoiding a resolution predicated upon uncertain or contingent future events. "To support a determination of facial unconstitutionality, voiding the [challenged provisions of the] statute as a whole, petitioners cannot prevail by suggesting that in some future hypothetical situation constitutional problems may possibly arise as to the particular *application* of the statute . . . . Rather, petitioners must demonstrate that the act's provisions inevitably pose a present total and fatal conflict with applicable constitutional prohibitions." (Pacific Legal Foundation v. Brown (1981) 29 Cal.3d 168, 180-181, orig. emphasis.) Nonetheless, the amend-

ment of article XVI, section 17, in 1984 requires close judicial scrutiny of changes to the status quo which threaten the trust protection of public employee retirement funds. "[A] major change [wrought by the amendment] was to specify that the trust funds held by a public pension or retirement system are to be administered in a manner to best provide benefits to the participants of the plan. (See, Historical Notes to Cal. Const., art XVI, § 17.) This change gave constitutional significance to the pre-existing statutory mandate that the " 'Public Employees' Retirement Fund is a trust fund created and administered . . ., solely for the benefit of the members and retired members of the system and their survivors and beneficiaries.' (§ 20200.)" (City of Sacramento v. Public Employees Retirement System, supra, 229 Cal. App.3d at p. 1493.)

Government Code section 20006, as enacted by Chapter 83, provides that the Actuary "shall be deemed to succeed to and assume the fiduciary obligations pertaining to actuarial determinations previously held by members of the board, including, but not limited to, those set forth in Section 17 of Article XVI of the California Constitution." We must assume, consistent with our limited scope of review, that the Actuary in carrying out the assigned duties will comply with this mandate.

Section 20006.1 provides that the Actuary shall "make an actuarial investigation into the mortality, service, and compensation experience of members and persons receiving benefits", make an "actuarial valuation of the assets and liabilities of this system", and "determine the rate of interest being earned on the Retirement Fund . . . ." [9]

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[9] Section 20006.1 provides: "On an annual basis, no later than December 1 of each year, the actuary shall make an actuarial valuation of the liabilities for benefits under this part on account of employees of the state. As of the effective date of this section, and thereafter at the end of periods not to exceed four years, the actuary shall make an actuarial investigation into the mortality, service, and compensation experience of members and persons receiving

Under the prior law these functions were carried out by the PERS Board based upon calculations and advice of actuaries "regularly employed . . . by the [PERS] board or the chief actuary's designee." (Stat. 1979, ch. 1110, § 3, eff. Sept. 28, 1979.)

We will assume that article XVI, section 17, imports the existing law of trusts and that the Actuary must satisfy its requirements for fitness to serve as a trustee. A trustee may be removed by a court for misconduct, unfitness, or acquisition of an adverse interest. (See, e.g., Prob. Code, § 15642; 11 Witkin, Summary of Cal. Law (9th ed. 1990) Trusts, § 55.) Petitioners cite numerous cases in which trustees subject to a conflict of interest have been sanctioned. These cases involve a conflict which resulted in an identified breach of trust. The claim in this case is tendered in the absence of an actual breach of trust. The cases relied upon are therefore inapposite.

There is no precedent in the law of trusts for the circumstance in which a legislature has created the office of actuary and it is claimed that the manner of appointment to the office constitutes a categorical conflict of interest. Ordinarily the Legislature is free to prescribe the law of trusts. Viewing the Legislature in this circumstance as analogous to the settlor of the PERS trust, there is no breach of the trust law. Where a trustee is named by the settlor who is aware of the possible conflicts of interest inherent in the appointment, removal on the ground of conflict of interest is ordinarily unwarranted without an actual breach of trust. (See, e.g., Estate of Gilliland (1977) 73 Cal.App.3d 515, 528; Rest.

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benefits and an actuarial valuation of the assets and liabilities of this system. From time to time, the actuary shall determine the rate of interest being earned on the Retirement Fund after deducting from earnings amounts applied to costs of administration of the system."

2d Trusts, § 107, com. f.[10]) The bare potential for a conflict of interest does not categorically bar a fiduciary from functioning as a trustee.

The most forceful of Petitioners' claims of conflict of interest is that under section 20006 (*ante*, at p. 11) the Actuary's contract is subject to termination at the will of the Governor. That is the reading initially adopted by the Governor. His original contract proposal provided for termination of the Actuary's contract on 30 days notice. Section 20006 provides that the contract of appointment "shall be for a fixed period of time not to exceed three years as determined by the Governor." We asked the parties whether termination at will is consistent with this provision. The Governor responded that section 20006 precludes him from terminating the Actuary's contract without just cause during the "fixed" period of the contract and that the contract executed with the Actuary will so provide.

This is our construction of section 20006. The term "fixed period" implies that the contract is not subject to termination at will. (Compare Lab. Code, §§ 2924, 2922.) Section 20006 contains several provisions which minimize the possibility that the Governor might attempt to influence the performance of the Actuary's duties through the power of selection. The Actuary must be an enrolled actuary,[11] the compensation must be fixed by the contract, the Actuary may not be awarded a "successive" con-

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[10] We note the following caveat in Restatement Second of Trusts section 107, comment f: "In such a case [where the trustee seems subject to a conflict], however, the conduct of the trustee in the administration of the trust will be subject to careful scrutiny; and if it appears to the court that because of his interest or otherwise he is unduly favoring himself and not fairly exercising the discretion conferred upon him, the court will remove him as trustee."

[11] An "enrolled actuary" means an actuary enrolled under subtitle C of Title III of the federal Employee Retirement Income Security Act of 1974. (See § 7507.)

tract,[12], must assume the fiduciary obligations formerly assigned to the PERS Board, and the Legislature must approve the choice of the Actuary. (§ 20006.) These provisions underscore the view that the "fixed period" serves a similar purpose. This reading is favored because it minimizes the prospect of an unconstitutional conflict with article XVI, section 17 of the California Constitution. (See Assoc. for Retarded Citizens v. Department of Developmental Services (1985) 38 Cal.3d 384, 394.)

The pertinent question is whether the selection of the Actuary by the Governor under these conditions places the Actuary in a position hopelessly in conflict with the fiduciary obligations imposed by article XVI, section 17. We think not. The safeguards enacted in section 20006 sufficiently insulate the Actuary from control by the Governor so as to permit the Actuary to function as a fiduciary. Those duties are constitutionally prescribed by article XVI, section 17. This implicitly subsumes the principle of trust law that the Actuary's primary duty is to the beneficiaries of the trust. (See City of Sacramento v. Public Employees Retirement System, supra, 229 Cal.App.3d at p. 1494.)

B. *The Law of Trusts Does Not Require That Actuarial and Other Functions Be Performed by the Same Trustees*

Petitioners claim that the transfer of actuarial functions is inconsistent with the law of trusts because the PERS Board trustees cannot administer PERS without the power to control the Actuary. We asked the parties whether a division of trustee functions would be per-

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[12] The term "successive" does not preclude subsequent appointments of the same actuary. Whether this is subject to redress for abuse by manipulation of the frequency and terms of the contracts is an issue we do not reach as it may never arise. As we note in the text, an abuse of the process of selection which impairs the fiduciary obligations of the Actuary is subject to judicial scrutiny.

missible under the law of trusts if we viewed the Actuary and the PERS Board as cotrustees or the Actuary as a special trustee. Petitioners suggest that these doctrines cannot be applied because cotrustees must supervise each other. The Governor replies that nothing in the law of trusts precludes the division of functions resulting from Chapter 83 among cotrustees or special trustees. The Governor has the more persuasive argument.

Petitioners suggest that under California law cotrustees must act unanimously, citing Probate Code section 15620. However, that statute belies the assertion since it merely prescribes unanimity unless otherwise provided in the trust instrument. As the Governor notes, Restatement Second of Trusts section 194, comment d, indicates a general rule that powers can be divided among trustees if it is so provided by the terms of the trust. The comments to section 185 of the Restatement show that discretionary powers may be assigned to nontrustees, who may also be subject to fiduciary obligations.

Petitioners suggest that the division of powers is inconsistent with the law of trusts because it imposes on each trustee the duty to participate in the administration of the trust and to take reasonable steps to prevent or cure a breach of trust by fellow trustees. (See Prob. Code, 16013). It is not a necessary consequence of these obligations that all trustees be given an equal share of the duties or powers accorded by the trust instrument. If that were the case there would be no doctrine of special trustees or holders of special powers.

While there may be legitimate concerns regarding a potential conflict of interest, we cannot assume that the Actuary will not faithfully adhere to the fiduciary obligations imposed upon it. Given their facial challenge Petitioners "cannot prevail by suggesting that in some future hypothetical situation constitutional problems may possibly arise" from the application of Chapter 83. (Pacific

Legal Foundation v. Brown, supra, 29 Cal.3d at p. 180.) Petitioners point to no case law nor doctrine in the law of trusts which can reasonably be applied under the aegis of article XVI, section 17, to categorically bar the Actuary from acting as a fiduciary under a section 20006 contract. If the Actuary violates those obligations Petitioners may seek judicial relief in the manner of all other beneficiaries of a trust.

C. *The Transfer of Actuarial Functions Is Not Invalid On Grounds of Improper Urgency Statute, Impairment of Contract, Denial of Due Process, Or Improper Delegation*

That leaves several less developed claims of invalidity of the transfer of actuarial functions. Petitioners contend that the transfer of functions is founded on a pretextual declaration of urgency, improperly impairs a vested contract right to have the PERS Board perform those functions, denies due process of law, and improperly delegates legislative authority without appropriate safeguards or standards. These claims warrant no extended discussion.

Petitioners suggest that the transfer of function provisions contravene California Constitution, article IV, section 8, subdivision (d), which defines the term "urgency statute." The argument is elliptical and undeveloped except for the claim that the "fiscal emergency" proffered by the Legislature as the grounds of urgency are pretextual. Petitioners cite Sonoma County Organization of Public Employees v. County of Sonoma (1979) 23 Cal.3d 296 in support of the suggestion that this court may freely "look past the bald assertion" of "fiscal emergency." However, that case is inapposite. It addresses the topic of review of a justification for a contract impairment and not the standard applicable to review of a declaration tendered to justify an urgency statute. As the Governor suggests, the latter scope of review is exceedingly limited (e.g., Davis v. County of Los Angeles (1938)

12 Cal.2d 412, 422-423) and Petitioners make no showing invoking such review.

Petitioners suggest that the transfer impairs contract rights of PERS members and of the City of Sacramento, which made a contract with PERS calling for employer contributions "subject to adjustment by [the PERS] Board." These claims are groundless for the reasons given in response to the contention that the mandatory second tier provision impairs a vested contract right. (Discussed in § I(b)(3), *ante.*) There is no ground for implying a statutory promise that the duty of performing these functions would not be transferred to another entity. There is a similar shortcoming in the argument regarding the City of Sacramento. Assuming for the sake of discussion that Petitioners are proper parties to raise purported rights under that contract, the claim is even weaker, since the state has no obligation of payment under that contract. (See, Cal. Teachers' Assn. v. Cory, supra, 155 Cal.App.3d at p. 511.)

That brings us to the claim that the transfer of functions violates both substantive and procedural due process of law. As to substantive due process (see 7 Witkin, Summary Cal. Law, supra, Constitutional Law § 481, p. 669) Petitioners claim that the transfer is arbitrary. Their legal argument is perfunctory, consisting of a bare citation of a police power case. The citation is inapposite. The wisdom of the legislation is not within our purview. (See American Bank & Trust Co. v. Community Hospital (1984) 36 Cal.3d 359, 369.) The determination of which of two lawful ways of performing the transferred actuarial functions is preferable is a policy judgment for the Legislature. Petitioners offer no persuasive backing for their claim that the alternative selected by the Legislature is irrational.

Petitioners also claim that the transfer scheme violates procedural due process because it does not afford PERS

members notice and a hearing on the determinations assigned to the Actuary. They suggest they have a property right to an actuarially sound PERS funds which may be violated by mistakes the Actuary makes in setting employer contribution rates too low which warrants procedural due process protection. We will assume for the sake of discussion that Petitioners are correct. The claim nonetheless fails on two threshold grounds.

Petitioners make no examination of what process is due. For example, they do not examine the adequacy of the process afforded by judicial review. We are not inclined to develop their gossamer argument on this point in light of their burden to establish the claim of unconstitutionality.

The second shortcoming is that Petitioners fail to show an entitlement to the remedy they seek. They seek to invalidate the transfer of functions on this ground in order to revive the former statutory scheme. (Voiding every statutory mechanism to set employer contributions is no help; that would work the same deprivation of the claimed property right.) However, the former scheme can as easily be faulted along the same lines.

Petitioners suggest that the former scheme provided superior notice and an opportunity to be heard because under it they were afforded the "opportunity to review" proposed actuarial determinations in a hearing before the PERS Board. They fail to cite authority for this claim. If the opportunity is a matter of practice, the same practice could be adopted by the Actuary. The deficiency in process, if any, is not attributable to a difference in the statutory schemes. (Cf. 7 Witkin, Summary Cal. Law, supra, Constitutional Law, § 519.) Petitioners' remedy, if any, is to seek the creation of an appropriate administrative process by implication from the present statutory scheme. (See generally, Southern Pacific Transportation Co. v. State Board of Equalization (1987) 191 Cal.App.3d

938, 950.) They seek no such remedy in these proceedings, and in view of the undeveloped nature of their arguments, we imply no view of the matter beyond the conclusion that their claim of invalidity is not meritorious.

That leaves their claim that the delegation of powers to the Actuary is improper. Petitioners do not explain how the transfer of functions provides less of a standard for the exercise of the actuarial functions than the antecedent scheme. In light of Petitioners' sketchy argument it suffices to say that the standards for the conduct of the Actuary appear sufficiently set out in Chapter 83 when coupled with the implication that the field of actuarial practice is subject to professional norms known to its practitioners and enforceable, if need be, by the judiciary.

DISPOSITION

None of the claims of invalidity of Chapter 83 tendered by the Petitioners has merit. The alternative writ is discharged and the petition is denied. *(CERTIFIED FOR PUBLICATION.)*

BLEASE, J.

We concur:

PUGLIA, P.J.

DAVIS, J.

APPENDIX B

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT
(Sacramento)

C011580

PEGGY J. CLAYPOOL, *et al.*,
Petitioners,

v.

PETE WILSON, as Governor *et al.*,
Respondents.

ORDER OF MODIFICATION

[Filed Apr. 13, 1992]

THE COURT:

The opinion of this court filed on March 12, 1992, is modified as follows:

1. On page 30 of the opinion delete the last sentence and insert the following sentence instead.

"Because Chapter 83 has a mandatory second tier under which most new state employees who are miscellaneous and state industrial members of PERS would make no member contributions (§ 20013.75) we asked the parties to factor the absence of such contributions into their calculations of projected benefits under *both* supplemental Cola programs."

2. On page 28 of the opinion delete the first sentence, insert the following sentence and footnote instead and renumber the succeeding footnotes appropriately.

"Petitioners locate the disadvantage principally in the lowered purchasing power maximums for the new supplemental Cola benefits under section 21235.5.[3] "

3. On page 12 delete the last sentence of the first paragraph and insert the following sentence instead.

"Petitioners concede that the funds, credited to retired member accounts, became employer assets for purposes of the effect on the employers' contribution obligations, since they were available to make up part of the ordinary retirement allowance."

This modification does not affect the judgment.

(CERTIFIED FOR PUBLICATION.)

FOR THE COURT:

PUGLIA, P.J.

BLEASE, J.

DAVIS, J.

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[3] Petitioners assert in a reply memorandum that the new supplemental Cola program has the disadvantage of a funding mechanism which generates lower funding in years when the rate of earnings on employee contributions is low. As appears in the text the evidence under the appropriate assumptions shows greater average benefits under the new supplemental Cola program. This is an advantage that compensates for the fluctuations that may occur in poor earnings years.

APPENDIX C

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT
(Sacramento)

C011580

PEGGY J. CLAYPOOL, *et al.*,
Petitioners,

v.

PETE WILSON, as Governor *et al.*,
Respondents.

OPINION ON DENIAL OF PETITIONS
FOR REHEARING

[Filed Apr. 13, 1992]

Petitioners and respondent PERS Board seek rehearing on numerous grounds. The Governor contends that none of their claims warrant granting rehearing. We agree. Most of the claims need no discussion as the opinion denying the application for writ of mandate (Opinion) or the Governor's answer to the petitions for rehearing provides a satisfactory response.

Preliminarily we note that the PERS Board suggests that rehearing is mandatory for failure of the court to afford it an opportunity to present its views upon principles of law it claims were not proposed or briefed by either party, as required by Government Code section 68081. Section 68081 is as follows: "Before [rendering a decision] based upon an issue that was not proposed or

briefed by any party to the proceeding, the court shall afford the parties an opportunity to present their views on the matter through supplemental briefing. If the court fails to afford that opportunity, a rehearing shall be ordered upon timely petition of any party."

The Board misreads the section. It is addressed to issues. If an issue has been tendered the court may apply rules, principles, or theories of law to its resolution without affording mandatory supplemental briefing. The language of Senate Bill No. 2321, the vehicle by which section 68081 was enacted, was amended to substitute the word "issue" for the phrase "a rule, principle, or theory of law." (Assem. Amend. to Sen. Bill No. 2321 (1986 Reg. Sess.) July 9, 1986.) Doubtless this change reflects a desire to avoid an endless cycle of mandatory rehearings that could be broken only by parroting the briefs of one of the litigants. None of the claims presented in the petitions for rehearing show that the Opinion is based upon an "issue" that was not proposed or briefed by a party.

I

Petitioners contend that the Opinion's conclusion that the mandatory second tier provision does not unconstitutionally impair rights of contract is erroneous. They argue that it is inconsistent with the legislative history of the former supplemental Cola provisions, which they claim shows that, in the removal of sunset provisions, the Legislature intended them to be permanent. The argument misses the point. We assume the premise to be correct; however, most legislation is intended to be permanent in the sense that the Legislature does not foresee its repeal when enacted. That does not mean there is a statutory *promise* not to adversely alter related statutes. In any event we note that there is still a supplemental Cola program, only not the one Petitioners desire.

II

Petitioners contend that the Opinion is based upon the false assumption that Chapter 83 eliminates employee contributions. They suggest that the court is not aware that the mandatory second tier provision applies only to new state miscellaneous and state industrial employee members. The court is aware of the limitation and the Opinion will be modified to make this manifest. Petitioners argue that rehearing is appropriate because the effect of imposing the mandatory second tier on the former supplemental Cola programs was "not fully developed in the briefs." This issue was squarely posed by the court's questions to the parties and Petitioners make no satisfactory explanation for their failure to develop the matter when given an opportunity to do so. As the Opinion notes, Petitioners took the position that the effect of the second tier provision was critical. Their application for rehearing fails to show the existence of new material evidence likely to change the resolution of the issue.

III

Petitioners contend that the Opinion is deficient in failing to note an additional disadvantage of the new supplemental Cola funding mechanism. They note that in a reply memorandum they asserted that the new supplemental Cola program has the disadvantage of a funding mechanism which generates lower funding in years when the rate of earnings on employee contributions is low. But they do not show in what way this observation reveals a deficiency in the Opinion. The evidence shows that greater *average* benefits would accrue to beneficiaries given the validity of the mandatory second tier provision. This is an advantage that compensates for fluctuations that may occur in poor earnings years. The opinion will be modified to address this point.

IV

The PERS Board contends that the Opinion is based on the false premise that the PERS fund is presently in actuarial balance.

Here, as in Valdes v. Cory (1983) 139 Cal.App.3d 773, the relationship between the employers' periodic contribution obligation and the attainment of actuarial soundness has never been adequately developed by the litigants. For that reason we did not specify what actuarial measure is to be applied to the obligation. The PERS Board submits that the PERS fund is not presently actuarially sound, that there is an unfunded liability which exceeds the present annual periodic contribution obligation. This is immaterial under the rationale of the Opinion.

If there is a present unfunded liability the implication to be drawn is that the contractual obligation of PERS employers to make periodic contributions either requires something less than the actuarial balance of funds and liabilities or is predicated upon a schedule under which actuarial soundness will be achieved at a point in the future by incremental progress. (See Gov. Code, § 20130.5.) In either event, the measure of the PERS employers' contract obligation is to periodically supply funds needed to reach the target level. The PERS Board does claim that there is some contractual constraint which requires the State to close the gap of unfunded liability more rapidly than called for by the periodic contribution obligation. Accordingly, that gap has no bearing on the reasoning presented in the Opinion.

V

The PERS Board claims that the Opinion's reasoning is incorrect because it permits the former supplemental Cola funds to be credited immediately rather than amortized as is the actuarial practice with unanticipated gains

and losses.[1] The PERS Board offers scant evidence of the stringency, nature, or extent of the claimed practice upon which this untimely new argument is founded. There is no showing that such a practice, if any, applies to the unique circumstances of this case. It might well be prudent to amortize peaks and valleys in earnings, on the notion that whatever economic force has swung the pendulum in one direction may well rebound during the amortization period. But the funds in issue are not analogous to earnings in this respect.

VI

The PERS Board claims that the Opinion is mistaken in asserting that Petitioners concede that pour over funds credited to retired member accounts under the former supplemental Cola scheme "became employer assets, since they were available to make up part of the ordinary retirement allowance." It acknowledges that Petitioners adduced a flow chart developed by PERS staff depicting the funding scheme and that it calls this crediting a transfer to "employer assets." It disavows this characterization as legally and factually incorrect. However, since the transfer results in funds which are to be counted in the calculation of the employer contribution obligation[2] the gist of the characterization is fair. However, in the interest of clarity we will modify the Opinion to qualify the characterization.

---

[1] The argument offers dubious benefits to Petitioners at best, since deferred crediting would not prevent the use of the former supplemental Cola funds to defray employer contributions, but only require that the offset be taken over time.

[2] Petitioners' expert actuarial witness described the credit transfer as follows. "Monies which spill over from the IDDA account go first to a retired life reserve . . . which has the effect of reducing employer contributions."

VII

The PERS Board claims that the Opinion is incorrect in equating the process due under the present and former schemes for setting actuarial standards because it is subject to the Bagley-Keene Open Meeting Act (Act; Gov. Code, §§ 11120-11131) but the Actuary is not. It fails to identify the provisions of the Act which provide for notice and an opportunity to be heard. In fact the requirement under the Act for a public meeting, falls far short of a due process hearing, even of the notice and comment variety. (See generally, 2 Davis, Administrative Law Treatise (2d ed. 1979) (Chapter 10.)

DISPOSITION

The petitions for rehearing are denied.

BY THE COURT:

PUGLIA, P.J.

BLEASE, J.

DAVIS, J.

APPENDIX D

Third Appellate District No. C011580
S026183

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA
IN BANK

PEGGY J. CLAYPOOL *et al.*,
Petitioners

v.

PETE WILSON, ETC. *et al.*,
Respondents

[Filed Jun. 18, 1992]

Petitions for review DENIED.

Mosk, J. and Kennard, J. are of the opinion the petitions should be granted.

The request for an order directing depublication of the opinion is denied.

/s/ Lucas
Chief Justice

APPENDIX E

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

Article XVI, section 17, adopted in 1984, in pertinent part reads as follows:

> "Notwithstanding provisions to the contrary in this section and Section 6 of Article XVI, the Legislature may authorize the investment of moneys of any public pension or retirement system, subject to all of the following:
>
> "(a) The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.
>
> "(b) The fiduciary of the public pension or retirement system shall discharge his or her duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system."

The California Government Code, as of January 1, 1991, included the following provisions:

20026. "Regular interest" means interest at the annual interest rate fixed by the board for purposes of crediting of interest, compounded annually.

20026.1. "Annual interest rate" means the interest rate fixed by the board for purposes of crediting interest.

20100. The board of administration of this system is continued in existence.

It consists of:

(a) One member of the State Personnel Board, selected by and serving at the pleasure of the State Personnel Board.

(b) The Director of the Department of Personnel Administration.

(c) The State Controller.

(d) The State Treasurer.

(e) An official of a life insurer and an elected official of a contracting agency, appointed by the Governor.

(f) One person representing the public, appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.

(g) Six members elected under the supervision of the board as follows:

(1) Two members elected by the members of the system from the membership thereof.

(2) A member elected by the active state members of the system from the state membership thereof.

(3) A member elected by and from the active local members of the system who are employees of a school district or a county superintendent of schools.

(4) A member elected by and from the active local members of the system other than those who are employees of a school district or a county superintendent of schools.

(5) A member elected by and from the retired members of the system. This section shall become operative on January 16, 1984.

20127. The board shall keep in convenient form such data as is necessary for the actuarial valuation of this system. As of June 30, 1950, and thereafter at the ends of periods not to exceed four years, it shall cause to be

made an actuarial investigation into the mortality, service and compensation experience of members and persons receiving benefits and an actuarial valuation of the assets and liabilities of this system. From time to time it shall determine the rate of interest being earned on the Retirement Fund after deducting from earnings amounts applied to costs of administration of the system.

20130. Upon the basis of any or all of such investigation, valuation, and determination, the board shall adopt such mortality, service and other tables and annual and actuarial interest rates as it deems necessary.

A change in interest rate adopted by the board shall not apply to any election of a member to deposit or redeposit contributions, including interest, filed prior to the date such change was placed into effect.

20131. The board shall credit all contributions of members and retired members in the retirement fund with interest at the current annual interest rate, compounded at each June 30th. The board may set the current annual interest rate at the level which provides for the maintenance of the Investment Dividend Disbursement Account and the Purchasing Power Accounts as specified in Section 21235, 21236, and 21237. For the purposes of this section, the current annual interest rate shall be not less than the current actuarial interest rate. In crediting interest for any fiscal year to contributions of members made during that year, the board may apply one interest rate to the total of such contributions made through the month next preceding the date through which interest is credited, under the assumption that such contributions were made in equal monthly amounts from the July 1st next preceding, to said month, both inclusive.

20200. The "State Employees' Retirement Fund" in the State Treasury is continued in existence. On and after October 1, 1967, said fund shall be known as the "Public Employees' Retirement Fund."

The Public Employees' Retirement Fund is a trust fund created, and administered in accordance with the provisions of this part, solely for the benefit of the members and retired members of the system and their survivors and beneficiaries.

20201. The board has the exclusive control of the administration and investment of the Retirement Fund.

20203.3. Notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of the system, investments for the benefit of the system, and the provision of benefits to the members and retired members of the system and their survivors and beneficiaries.

20652. If the state service or membership herein of a member is discontinued, he or she shall, upon his or her request, be paid his or her accumulated contributions, if, in the opinion of the board, he or she is permanently separated from state service or membership by reason of the discontinuance.

This section shall not apply to discontinuance of state service or membership as a result of retirement or death on account of which a basic, a limited, or a special death benefit is payable.

20684. Each member's contribution deducted and remitted or otherwise paid to the board shall be credited by the board, together with regular interest, to an individual account of the member for whom the contribution was made. Payment of salaries or wages less such contribution is in full discharge of all claims and demands whatsoever for the service rendered by the members during the period covered by such payment, except the benefits afforded by this part.

20750.9. The rates of contribution fixed under this chapter shall be effective on the operative date of the amendments to this section at the 1971 Regular Session; provided that if such rate is greater than the current

rate of a contracting agency, its effectivity shall be deferred and the current rate continued with respect to such agency on request of its governing body until July 1, 1972, in which case an amount equal to the additional contributions which would have been made by the contracting agency had such deferral not occurred shall be transferred from the contributions of the contracting agency held for liability to be funded pursuant to Section 20750.8 to the contributions held for liabilities of all employers in accordance with Section 20758. Rates of contributions as fixed under this chapter shall be adjusted thereafter from time to time by the board pursuant to actuarial valuation of the liability for benefits on account of the employees of all public employers. Any adjustment of such rate of contribution shall be effective on the July 1 following notice as provided in this section. The board shall report such adjustment to the Governor, the Legislature, and the governing body of every other public employer before March 1 of the fiscal year preceding that in which the adjustment becomes effective.

21235. (a) The board shall establish an Investment Dividend Disbursement Account in the retirement fund consisting of that amount of the earnings of the retirement fund which remains after the sequential application of Sections 20202.5, 20203, 20131.1, and 20131. The board shall establish in the retirement fund such Purchasing Power Accounts, based on relative purchasing power, as the board deems necessary, which Purchasing Power Accounts shall consist of the amount of earnings of the retirement fund determined pursuant to Section 21237.

(b) The Investment Dividend Disbursement Account may be utilized, as specified in subdivision (e), to increase all monthly allowances paid by the system to an amount equal to a maximum of 75 percent of the purchasing power, as determined by the board, of the initial monthly allowances that were received by every retired

person or survivor or beneficiary of a state, school or local member or retired person who was eligible to receive any allowance at the end of each fiscal year. If sufficient funds are not available within a Purchasing Power Account to adjust allowances to a maximum of 75 percent of purchasing power, the board may transfer funds maintained in the Investment Dividend Disbursement Account to the Purchasing Power Account to provide for the increases authorized by this section. If sufficient funds are not available in any particular Purchasing Power Accounts to adjust allowances to a maximum of 75 percent of purchasing power, the board may adjust allowances to eligible recipients by a lesser amount. The board may, for reasons of insufficient funds, determine that no increase under this section shall be made.

(c) The amount specified in subdivision (a) is hereby appropriated from the Investment Dividend Disbursement Account and from such Purchasing Power Accounts as have been established to the board without regard to fiscal years. Whenever the board determines that there are sufficient funds the board shall apply those funds to the increases authorized by this section.

(d) The board shall inform each recipient of benefits under subdivision (b) that the increases are not cumulative, not part of the base retirement allowance, and may be available for only a limited period of time and that the board may discontinue the increases.

(e) The board, on January 1, 1984, and, upon the commencement of each quarter thereafter, shall pay the benefit provided by this section for the succeeding quarter.

21236. (a) The board shall pay, on October 1, 1984, and at the beginning of each succeeding calendar year, from any funds in a Purchasing Power Account not then needed for the purposes of Section 21235, the amount required for the purposes of this section, which is appropriated to the board without regard to fiscal years, for use for the sole purpose of providing quarterly increases

as specified in subdivision (d) in the monthly allowance of every person who was eligible to receive the 10 percent quarterly increase provided by Section 21232 on September 30, 1984.

(b) Whenever the board determines that there are sufficient funds in a Purchasing Power Account, the board shall apply those funds to the increases authorized by this section. If the funds in a Purchasing Power Account are not sufficient to pay the increases prescribed in subdivision (d), the board shall proportionately reduce all payments.

(c) The board shall inform each recipient of benefits under subdivision (a) that the increases are not cumulative and shall not be included in their base allowance and may be available for only a limited time.

(d) The total quarterly increases payable shall be the difference between the July 1, 1984, 10 percent quarterly payment under Section 21232 and the amount payable under Section 21235 at the time a payment under this section would be made. Whenever the amount payable under Section 21235 is equal to or greater than the amount payable under Section 21232 on July 1, 1984, there shall be no amount payable under this section.

21237. (a) Notwithstanding any other provision of this part, effective January 1, 1986, the Investment Dividend Disbursement Account shall consist of an amount not to exceed the amount of the funds transferred from the Reserve for Deficiencies to the Investment Dividend Disbursement Account on June 30, 1983, less the amount of investment earnings attributable to member accounts for fiscal year 1982-83, plus future account earnings. The board shall annually credit interest to the account at the same crediting rate used to credit retired member reserves. The board may utilize the earnings on the account attributable to the period from June 30, 1983, through June 30, 1985, to credit contributions of members in the retirement fund. That additional interest credit-

ing shall not exceed one percent of the balances in member accounts. Transfers authorized by the board pursuant to subdivision (b) of Section 21235 shall reduce the maximum allowable account balance by the amount transferred.

(b) All other funds available pursuant to Section 21235 shall be retained in Purchasing Power Accounts. The board shall annually transfer from the Purchasing Power Accounts any funds in excess of the amounts disbursed pursuant to Sections 21235 and 21236 in the four previous fiscal years, as provided in subdivision (c). Of the amount so transferred, an amount not to exceed the amount disbursed from the Purchasing Power Accounts in the immediately preceding fiscal year shall be transferred to the appropriate retired member accounts, as determined by the board; and the residual amount shall be transferred to the Extraordinary Performance Dividend Account.

(c) The board shall annually determine, pursuant to subdivision (c) of Section 21221, the extent to which the purchasing power of benefits provided by the system have decreased. The board shall annually transfer from the Purchasing Power Accounts, as provided in subdivision (b), any funds in excess of those disbursed pursuant to Sections 21235 and 21236 for the four previous fiscal years.

21238. (a) The board shall establish an Extraordinary Performance Dividend Account in the Retirement Fund consisting of the amount of earnings of the Retirement Fund transferred from the Purchasing Power Accounts pursuant to Section 21237.

(b) The board shall from time to time on or after January 1, 1991, but only in a fiscal year in which the purchasing power of all persons receiving payments from the Purchasing Power Accounts is 75 percent, disburse, not more frequently than quarterly, extraordinary performance dividend payments to those retired persons and

those survivors and beneficiaries of state, school, and local members and retired persons whose allowances, after applying the annual cost-of-living adjustments and all other increases in allowances required or authorized by this part, have the lowest purchasing power percentage, based on the amount that would be paid had the original allowance been increased by increases in the Consumer Price Index, as defined by subdivision (c) of Section 21221, increasing those allowances to a common minimum purchasing power level. The payments shall be paid by a separate identifiable warrant.

(c) The amount specified in subdivision (a) is hereby appropriated from the Extraordinary Performance Dividend Account to the board without regard to fiscal years. Whenever the board determines that there are sufficient funds in the Extraordinary Performance Dividend Account, the board shall apply that portion of those funds deemed prudent by the board to any payments authorized by this section.

(d) The board shall inform each recipient of benefits under subdivision (b) that the payments are not cumulative, not part of the base retirement allowance, and may be available only as a result of extraordinary investment returns to the system.

1991 Cal. Stat. ch. 83 repealed, *inter alia*, Cal. Gov't Code §§ 20131, 20750.9, 21235, 21236, 21237 and 21238. The following sections *inter alia*, were added or amended as follows:

§ 20006. Actuary; appointment; contract

(a) "Actuary" means an individual or firm practicing as an enrolled consulting actuary appointed by the Governor under contract with the Governer's Office. The contract shall not be subject to any provisions of law relating to competitive bidding. The contract shall be for a fixed period of time not to exceed three years as determined

by the Governor. The compensation paid to the actuary and other necessary employees of the actuary shall be fixed by the contract. The actuary under contract with the Governor's Office pursuant to this section may not be awarded a successive contract. All costs of the contract for the actuary shall be paid from the retirement fund on an annual basis. In carrying out duties under this part, the actuary shall be deemed to succeed to and assume the fiduciary obligations pertaining to actuarial determinations previously held by members of the board, including, but not limited to, those set forth in Section 17 of Article XVI of the California Constitution.

(b) The Governer shall submit the name of the actuary to each house of the Legislature. The actuary shall commence serving in office on the day after receipt of confirmation by both houses of the Legislature. However, the appointment shall become effective and be deemed confirmed the 61st calendar day after the submission of the nomination unless a majority of either house affirmatively rejects the nomination. If the 60-day period ends during a recess of the Legislature, the period is extended to the sixth day following the date on which the Legislature reconvenes.

§ 20006.1. Actuarial valuation of liabilities for benefits; investigation into mortality, service, and compensation; determination of interest rate

On an annual basis, no later than December 1 of each year, the actuary shall make an actuarial valuation of the liabilities for benefits under this part on account of employees of the state. As of the effective date of this section, and thereafter at the end of periods not to exceed four years, the actuary shall make an actuarial investigation into the mortality, service, and compensation experience of members and persons receiving benefits and an actuarial valuation of the assets and liabilities of this system. From time to time, the actuary shall determine the rate of interest being earned on the Retirement Fund

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after deducting from earnings amounts applied to costs of administration of the system.

§ 20013.75. Alternatives to Second Tier retirement plan: application

(a) It is the intent of the Legislature that the Department of Personnel Administration, in conjunction with the recognized state employee organizations, develop alternatives to the Second Tier retirement plan by June 30, 1992. The alternative plan may include enhanced benefits or provide benefits under a defined contribution program. However, the state employer's contribution to the alternative plan shall not be greater than the state's contribution rate to the current Second Tier. At the time that an alternative plan is agreed to and implemented, employees who were placed in the Second Tier shall be given an opportunity to elect coverage in the new alternative plan. In the event no alternative plan is implemented by June 30, 1992, employees shall remain in the Second Tier.

(b) Notwithstanding any other provision of this article, persons who first become state miscellaneous or state industrial members of the system on or after the effective date of this section who are: (1) excluded from the definition of state employee in subdivision (c) of Section 3513; (2) supervisory employees as defined in Section 3522.1; (3) employed by the executive branch of government who are not members of the civil services; and (4) defined in subdivision (c) of Section 3513 shall become subject to Section 21251.146.

(c) This section shall not apply to state miscellaneous members employed by the California State University or employees described in Section 20364.

§ 20026. Regular interest

"Regular interest" means interest at the annual interest rate fixed by the *actuary* for purposes of crediting of interest, compounded annually.

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§ 20026.1. Annual interest rate

"Annual interest rate" means the interest rate fixed by the *actuary* for purposes of crediting interest.

§ 20127. Data for actuarial valuation of system; actuarial investigation and valuation; rate of interest on fund

The board shall keep in convenient form such data as is necessary for the actuarial valuation of this system.

* * *

§ 20131.01. Disbursement of funds upon repeal of §§ 21235, 21236, 21237, and 21238

Funds remaining in the Investment Dividend Disbursement Account, the Purchasing Power Accounts, and the Extraordinary Performance Dividend Account upon the repeal of Sections 21235, 21236, 21237, and 21238, shall be used to reduce employer contributions in fiscal year 1991-92 and subsequent fiscal years until those amounts are depleted.

§ 20132.6. Credit of contributions of members and retired members in the retirement fund; interest; reductions; excess funds

(a) The board shall credit all contributions of members and retired members in the retirement fund with interest at the current annual interest rates compounded at each June 30. Except as provided in subdivision (b), the current annual interest rate shall not be lower than the current actuarial interest rate.

(b) In any fiscal year in which the net earnings rate does not exceed the current actuarial interest rate by 110 basis points, the current annual interest rate to be credited to member and retired member contributions may be reduced by an amount that is no more than 110 basis points

less than the net earnings rate in order to provide the amount specified in Section 21235.5.

(c) If the current net earnings rate exceeds the annual interest rate used to credit the member and retired member accounts, in addition to the amount transferred to the fund established under Section 21235.5, the remaining amount shall be credited to employer accounts.

(d) It is the intent of the Legislature that the annual interest rate for crediting member contributions and the actuarial interest rate shall be determined independently of the amount needed to fund Section 21235.5.

§ 20203.3. Expending of funds; limitation to administration of system, investments, reduction of employer contributions, and benefits to members

Notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of the system, investments for the benefit of the system, *the reduction of employer contributions*, and the provision of benefits to the members and retired members of the system and their survivors and beneficiaries.

§ 20652.5. Credit of accumulated contributions to member's account; interest

(a) Notwithstanding any other provision of this part, any member of this system who is paid his or her accumulated contributions shall receive the sum of all accumulated contributions credited to his or her account. The accumulated contributions shall include: (1) the interest which had been credited to the member's account prior to the effective date of this section; plus (2) the contributions and interest which had been credited after the effective date of this section at an interest rate of 6 percent annually compounded.

(b) The interest amount which would have been otherwise credited to the member's account on or after the effective date of this section, but for the return of the member's accumulated contributions, shall be transferred to the account established by the board under Section 21235.5 to fund the purchasing power protection allowance.

§ 20750.905. Adjustment of state contributions; determination of employer contribution rates

(a) Notwithstanding any other provision of law, the state's contribution as fixed under this chapter shall be adjusted thereafter from time to time in the annual Budget Act according to the following method. As part of the proposed budget submitted pursuant to Section 12 of Article IV, of the California Constitution, the Governor shall include the contribution rates submitted by the actuary of the liability for benefits on account of employees of the state. The Legislature shall adopt the actuary's contribution rates and authorize the appropriation in the Budget Act.

(b) The employer contribution rates for all other public employers under this system shall be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of change in rate.

§ 21235.5. Transfer of funds to supplemental account; utilization

(a) On an annual basis, the board shall transfer the lessor of: (1) the amount necessary to increase all monthly allowances paid by the system to 75 percent of the purchasing power of the initial monthly allowances; or (2) up to 1.1 percent of the net earnings on member contributions, as determined by Section 20132.6, to a supplemental account.

(b) The funds so transferred to the supplemental account shall be utilized to increase all monthly allowances

paid by the system up to a maximum of 75 percent of the purchasing power, as determined by the actuary, of the initial monthly allowances that were received by every retired person or survivor or beneficiary of a state, school or local member or retired person who was eligible to receive any allowance at the end of each fiscal year. Funds remaining in the account after the payment of benefits under this section shall be transferred to the employer accounts.

§ 21236.5. Duration of § 21235.5

If a court of competent jurisdiction, from which all appeals are final, holds that Section 20131.01 is invalid, Section 21235.5 shall become inoperative.

Supreme Court, U.S.
FILED
NOV 16 1992
OFFICE OF THE CLERK

No. 92-678

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

THE BOARD OF ADMINISTRATION OF THE PUBLIC EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF CALIFORNIA, *et al.*,

Petitioners,

v.

PETE WILSON, Governor of the State of California; GRAY DAVIS, State Controller of the State of California; KATHLEEN BROWN, State Treasurer of the State of California; and THOMAS W. HAYES, Director of the Department of Finance, State of California,

Respondents.

On Petition for a Writ of Certiorari to the Court of Appeal of California, Third Appellate District

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BRIEF AMICUS CURIAE FOR 14 SEPARATE PUBLIC EMPLOYEE RETIREMENT SYSTEMS IN SUPPORT OF PETITIONERS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-678

THE BOARD OF ADMINISTRATION OF THE PUBLIC EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF CALIFORNIA, *et al.*,

Petitioners,

v.

PETE WILSON, Governor of the State of California; GRAY DAVIS, State Controller of the State of California; KATHLEEN BROWN, State Treasurer of the State of California; and THOMAS W. HAYES, Director of the Department of Finance, State of California,

Respondents.

On Petition for a Writ of Certiorari to the Court of Appeal of California, Third Appellate District

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BRIEF AMICUS CURIAE FOR 14 SEPARATE PUBLIC EMPLOYEE RETIREMENT SYSTEMS IN SUPPORT OF PETITIONERS

INTEREST OF AMICI CURIAE

Pursuant to Rule 37.2 of the Rules of this Court, the public employee retirement systems whose names appear in the footnote below [1] file this brief of *amici curiae* in

[1] The Louisiana State Employees' Retirement System; The New Hampshire Retirement System; The Utah Employees' Retirement System; Board of Retirement, Los Angeles County Employees' Re-

support of petitioners.[2] Each of the 14 state or local retirement systems appearing as *amici curiae* in support of petitioners operates a retirement system that is regarded under local law as a trust fund and as having established a contractual obligation to public employees to provide a retirement system that includes benefits funded in part or in whole by employer contributions. As such, they are directly affected by the constitutional issue raised in the *Claypool* case, namely, whether a state or local governmental agency may impair its own contractual obligations to its public employees solely in order to save money in times of chronic budgetary stress.

State and local jurisdictions have faced and currently face budgetary problems and *amici curiae* have observed governmental efforts to solve those problems within their own jurisdictions and elsewhere by invading public pension funds to balance operating budgets. The law in all of these jurisdictions contains statutory or constitutional provisions that have traditionally been held to protect the contractual rights of retirees and active contributing members of the respective plans, but that protection is now threatened by the governmental action upheld against constitutional attack in the case before this Court.

This issue is of immediate concern to retirement systems throughout the United States because many state and local governments are facing budgetary constraints

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tirement Association; The San Bernardino County Employees' Retirement Association; The Connecticut Retirement and Trust Fund; The Oklahoma Public Employees Retirement System; The Oklahoma Uniform Retirement System for Justices and Judges; The San Jose Federal City Employees Retirement System; The San Jose Police and Fire Department Retirement Plan; The City Employees Retirement System for the City of San Diego; The Teachers' Retirement System of the State of Illinois; The Illinois Municipal Retirement Fund; and The Iowa Public Employees' Retirement System.

[2] Letters of consent from all parties have been filed with the Clerk.

and are increasingly looking to pension trust funds to redress their budgetary imbalances.[3]

Because of the experience of these systems with past constitutional issues raised in their own and other juris-

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[3] American Association for Retired Persons, "Toward a Just and Caring Society: The AARP Public Policy Agenda 1992," stating in part,

> "A current pension issue of concern for the states is attempts by governors and/or legislatures to use public employee pensions as funding vehicles for projects unrelated to the welfare of public employees and retirees. The majority of states are facing deficits and practically all states are required by law to balance their budgets, and so in addition to increasing taxes, some states are resorting to 'raids' on their public employee pension funds to finance spending initiatives and other spending commitments. Other states are revising the actuarial assumptions underlying their pension programs to show a more favorable funding situation and thereby justify diverting pension monies to other issues. . . .
>
> "1. States and other governmental entities should ensure that their retirement systems are actuarially sound and administered in a prudent manner that is solely in the interest of employees and beneficiaries.
>
> "2. Public employee pension funds must be safeguarded against use by governments seeking non-tax ways to increase revenues. Such actions are short-sighted and undermine the retirement security of millions of Americans who have come to count on these funds."

See also, PERSIST: (Public Employees Retirement Systems Issues Strategies and Tactics), newsletter of the National Conference On Public Employee Retirement Systems, Vol. 4, No. 2 (Sept. 1992) page 3, "Report From The Secretary Of Constitutional Concern," commenting as follows on the *Claypool* decision that is the subject of the Petition for certiorari:

> "Of concern is the size of the raid involved, almost $2 Billion, and the lower courts decision, which as [it] stands, encourages and condones like actions in other state and municipal jurisdictions. Of importance, therefore, is the potential risk and empty promises, which threaten current plan participants' employee packages. NCPERS continues to monitor this case, and if the writ of certiorari is granted, will once again substantiate our legal position to the United States Supreme Court to ensure the preservation and the integrity of public retirement systems."

dictions, the *amici* are very familiar with the issue presented, and believe that their views will be of assistance to this Court and will present a broader picture of the necessity for this Court's review.

STATEMENT

Amici curiae support petitioners' efforts to obtain Supreme Court review of the California Court of Appeal's decision upholding a 1991 statute in which the California legislature sought to resolve its current operational fiscal problems by using public retirement trust funds. It was the third time within ten years that the California legislature had sought to deal with fiscal problems by interfering with the flow of employer contributions to public pension funds.[4] This time the legislative interference with the pension fund was more detailed: (1) it repealed a previously enacted COLA program and substituted another, reduced benefit that would cost less money; (2) it used the retirement trust fund previously dedicated to the preexisting COLA program to pay employer pension contributions until the fund was used up; and (3) it eliminated the trustees' independent power to make actuarial decisions, and substituted a political appointee actuary, responsible only to the principal obligor of the fund.[5]

Although the state's purpose to correct its current budgetary imbalance was undisputed, the court below

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[4] *See Valdes v. Cory*, 189 Cal.Rptr. 212 (Ct.App. 1983) (rejecting employer's attempted use of money from a retirement fund reserve to replace state contributions), and *California Teachers Ass'n v. Cory*, 202 Cal.Rptr. 611 (Ct.App. 1984) (rejecting governor's "blue-line" reduction of appropriation for state contribution to teachers retirement system in order to use the money for "other educational purposes").

[5] On November 3, 1992, California voters restored the independence of the actuarial decisions by the passage of Proposition 162, the California Pension Protection Act. However, the use of trust funds by the state to pay its contributions remains uncorrected and ongoing.

held that any impairments to the contractual rights of employees were constitutionally permissible against the challenge to the statute primarily based on the U.S. Constitution art. I, § 10 (the "Contract Clause").

The factual background and proceedings below are adequately summarized in the Petition at pages 4 through 9 and will not be repeated here.

ARGUMENT

I. THE NATIONAL SIGNIFICANCE OF PUBLIC PENSION PLANS—TO THE EMPLOYEE MEMBERS, TO THE PUBLIC EMPLOYERS, TO THE TAXPAYERS AND TO THE NATION'S CAPITAL MARKETS—JUSTIFIES SUPREME COURT REVIEW OF A DECISION THAT SO DIRECTLY IMPACTS THEM

The overwhelming growth in the size of both the assets and the liabilities of public pensions in the 1980's makes their protection from budgetary raids a matter of national significance and necessity. The data set forth below show that public employee retirement systems loom large in this nation's economy. The funds are big; their membership is big; they provide the main source of retirement savings for their membership; and they are of critical importance to the taxpayers and to the nation's capital markets.

As of 1987 there were 201 state-administered public employee retirement systems and 2,213 locally administered systems, for a total of 2,414 systems.[6] These plans cover everyone from administrative and clerical public employees to police and fire personnel, teachers, judges, transit workers and other special district employees.[7]

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[6] U.S. Bureau of the Census, 1987 Census of Governments, Vol. 4, No. 6, *Employee Retirement Systems of State and Local Governments* (D.C. U.S. GPO 1988), at xii.

[7] *Id.* at 19.

Their number exceeded (as of 1987, the latest figures available) 11.7 million active members.[8]

In 1987, those funds held approximately $808 billion in assets,[9] growing to over $911 billion by the end of the second quarter of 1992.[10] Despite this immense total of assets, the pension assets were *exceeded* by the pension benefit obligations that they are designed to secure by an average of 15%, based upon a survey conducted in November 1991.[11] If pension underfunding grows, it will become a problem not only for the funds, but also for the taxpayers who will be called upon to pay for the unfunded pension promises made by public officials. The price to be paid in the future will be even higher if present funding obligations are ignored because then taxpayers will have to make up not only the contributions, but also the earnings that the contributions would otherwise have brought to the funds.[12]

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[8] *Ibid.*

[9] Board of Governors, Federal Reserve System, Flow of Funds Accounts: Financial Assets and Liabilities, Year-End 1967-1987.

[10] *Id.*, Second Quarter 1992 Annual Revisions, at 96.

[11] Survey of State and Local Government Employee Retirement Systems (Public Pension Coordinating Council, Washington D.C. Nov. 1991) at xiv.

"Public Employee Retirement Plans—The Nature Of The Employees' Rights," 1968 Ill. L. Forum 32: "The legal status of employees' rights assumes special significance in the light of the vast number of public employees who have coverage under state or local plans and the enormous fiscal obligations assumed by the public under these plans."

[12] "The Great Pension Robbery," Fortune, Jan. 13, 1992, at p. 76, stating:

> "The immediate victims of any cut in contributions or attachment of assets are the public employees whose retirement funds are being raided. But taxpayers may be on the hook too: they could have to make up the difference if, thanks to the raids, public plans lack the wherewithal to pay retirement benefits in the future."

Continued

In 1987, public pension assets represented 25.1% of total pension fund assets, with the remainder represented by union and corporate funds.[13] That percentage has grown, and today's $911.2 billion now represents 32.9% of total pension fund assets.[14] Pension funds have thus become a major source of the nation's capital.[15] Because of the importance of both their assets and liabilities and the interests of pensioners and of future taxpayers, the constitutional standard for protecting public pension funds is an issue of national significance that deserves review by this Court.

II. THE DECISION BELOW SHOULD BE REVIEWED BECAUSE IT IS THE LATEST AND LARGEST EXAMPLE OF THE INCREASING ABUSE OF PUBLIC PENSION FUNDS BY THEIR EMPLOYER SPONSORS

In almost every jurisdiction, including California, pension funds are treated as trust funds, and the Board members or others who administer the funds are re-

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[12] Continued

Chicago Tribune, Monday, May 20, 1991, Perspective, p. 10:

> "TRS [Teachers' Retirement System of Illinois] has never been funded on a sound basis. Reduced state contributions are being made into the accounts of employees, contributions that will have to be paid by future taxpayers at much higher cost. As of June 1990, the unfunded accrued liability of TRS was $5.58 billion. The underfunding of the public pension systems each year is creating another hidden debt for future taxpayers."

[13] "Our Money's Worth," Report of the Governor's Task Force on Pension Fund Investment (New York State Industrial Cooperation Council, June 1989) at 1.

[14] *Op. cit. supra*, n.9 at 96.

[15] "Our Money's Worth," *supra*, n.13, at 2. *See also* Hearing of the U.S. Senate Labor Committee, September 29, 1992, Testimony of Felix Rohatyn, Economist, Lazard Freres:

SEN. KENNEDY: I'm particularly interested in the role of the pension monies.

MR. ROHATYN: Yes. Public and private pension funds are the greatest accumulation of assets and savings in this country . . . .

garded as trustees and fiduciaries.[16] However, this protection will prove illusory if states can abrogate their statutory and constitutional obligations to treat pensions as trusts in order to use trust funds to balance their budgets. This case requires review because it is the largest and most egregious example of the increasing efforts by government to use retirement money to fund current operating expenses. This time the government is actually using retirement trust funds to pay its bill to the fund, despite the fact that it is contractually bound by the exclusive-benefit rule not to use trust assets for its own benefit.

In 1977, a law review note warned that the possibility of employer abuse of public pension funds was greater even than that among private pension plans, and that the possibility was becoming a reality.[17] The reality of that abuse has grown as the funds have grown from

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[16] *See* "Fiduciary Responsibility Requirements of the Pension and Retirement Plans For State Employees," Cong. Research Serv. Report 88-614 A (August 8, 1988), *passim*, noting fiduciary responsibility provisions, investment practices, and penalties for the fifty states; "Public Pension Plans: The Issues Raised Over Control of Plan Assets," Cong. Research Serv. Report (May 15, 1990) at 50, stating: "[A]ll states have a strong body of common trust laws as well as statutory trust laws to protect the financial integrity of pension trust funds."; "Fiduciary Duties and Other Laws Applicable to Public Retirement Systems," (National Council on Teacher Retirement, September 1992), *passim*, describing, separately as to each state, and reaffirming that "All states have either common law or statutory trust remedies." As to the application of common law trust principles to public pension trusts, *see, e.g., Board of Trustees v. City of Baltimore*, 562 A.2d 720, 739 (Md. 1989), *cert. denied*, 493 U.S. 1093 (1990), annot., 103 Harv. L. Rev. 817, analyzing the pension fund trustees' duty of loyalty in terms of common law trust principles in passing upon a South Africa divesture statute; *Hittle v. Santa Barbara County Employee Retirement Ass'n.*, 703 P.2d 73 (Cal. 1985), imposing duties on retirement association officers as trustees under California private trust law.

[17] Note, *Public Employee Pensions in Time of Fiscal Distress*, 90 Harv. L. Rev. 992 (1977), first quoting a 1976 congressional task

1977's estimate of over $100 billion [18] to 1992's Federal Reserve figure of $911.1 billion.[19] The financial problems of state and local governments have caused those governments to turn to public pension funds—held in trust to provide for retirement in the *future*—as a source of funds to meet the operating needs in the *present*, either by avoiding contributions or by arranging to take retirement savings to meet the state's current year operating expenses.

In 1977, the law review note spoke in terms of abuses by "alter[ing] the benefit and eligibility structure." [20] Today, the methods governments devise to use the public pension trust funds for their present needs are much more varied and ingenious:

(1) they may attempt to reduce benefits; [21]

(2) they may attempt to change actuarial funding methods in order to delay current pension contributions,

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force finding that "[t]he absence of any external independent review has perpetuated a level of employer control and attendant potential for abuse unknown in the private sector," and then stating:

"This 'potential for abuse' is becoming a reality in many areas. With public employee pension systems absorbing an increasingly large share of state and local revenues, financially troubled governments have begun increasingly to look to these systems as a source of fiscal relief."

[18] *Id.*, 90 Harv. L. Rev. at 32, n.2.

[19] Note 9, *supra*.

[20] *Op. cit. supra*, n.17 at 993.

[21] *See, e.g., Wisconsin Ex. rel. Cannon v. Moran*, 321 N.W.2d 550 (Wisc. 1982) (holding invalid a 1979 statute (as an impairment of contract) which sought to reduce state salaries of judges dollar-for-dollar by benefits they received under a county pension plan; the statute's purpose (*inter alia*) was to "reduce the costs imposed upon the Wisconsin public employee retirement systems and the public employers"); *Claypool v. Wilson* (Petition, App. A) (eliminating a brace of COLA programs and replacing them with a lesser program of asserted greater permanence).

and by so doing divert the public funds thus "saved" for non-pension purposes;[22]

(3) they may reduce annual contributions by the employer to the public retirement system;[23]

(4) they may raise investment return assumptions (which correspondingly lowers current employer contributions by assuming that existing funds already in the system will make more money than had been previously estimated);[24]

(5) they may deliberately underfund the pension plan;[25]

(6) they may transfer retirement trust funds out of trust and into general use accounts;[26] or

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[22] *McDermot v. Regan*, 587 N.Y.S. 2d 533 (1992), holding that statute seeking to change from aggregate cost method (the actuarial funding method used since 1921 to determine annual contributions by public employers to the common retirement funds) to projected unit credit method constitutes an "unconstitutional attempt to divest public employees of [a] contract right".

[23] "States Seeking Aid on Budgets From Pensions," NY Times July 21, 1991, sect. 1, pt. 1, p. 1, col. 1, describing how "At least 18 states . . . have delayed or reduced payments to their pension plans in the last two years, or are considering doing so." *See also* description of Texas rate reductions in Appendix A, p. 5a, *infra*.

[24] N.Y. Times article, *supra* n.23, Subhead "Tinkering With Assumptions."

[25] 1967 Report of the Illinois Public Employees Pension Laws Commission, Appendix B, Table 2, *cited in* R.G. Cohn, "Public Employee Retirement Plans—The Nature of the Employees' Rights," 1968 Ill. L. Forum 32, 33 n.4., describing how Illinois' state and local funds had accrued liabilities of just under $3.6 billion at the end of 1966 and net assets of approximately $1.65 billion, leaving an actuarially computed deficiency of approximately $1.95 billion as a public obligation. Compare *Crain's Chicago Business*, August 17, 1992, "Finance" section, asserting that "unfunded liabilities of Illinois will mushroom by 2020 to a projected $51 billion from the current $11.7 billion" and stating that "at least one of the state's five pension funds will go under by 2008."

[26] See "Statement of Facts" in the *Sklodowski* brief before the Illinois Supreme Court, Appendix A, page 3a below.

(7) they may offset their debt to the system by using funds already in the trust to pay their obligations to the trust, as in the case before the Court.

Claypool v. Wilson may be the biggest and the worst, but it is not the only example of misuse of retirement funds; if this sort of abuse is allowed to stand, it presages much more of the same conduct by state and local governments. In 1990 and 1991, public pension funds experienced a variety of threats when governments sought to divert pension trust funds, or divert money otherwise required to pay pension contributions to other purposes. They ranged from changes in actuarial assumptions or in the methods by which they were determined (so as to lower present contribution amounts—while raising those in the future); to shifts in the power of actuarial computation to those who have an economic interest in controlling it; to changes directly affecting the frequency or amounts of employer contributions; or to changes resulting in direct transfers or mandatory "loans" of trust fund money to the public employer. A more detailed description of these changes appears at Appendix A below.

Court review is necessary to halt these abuses that threaten the security and soundness of public pensions, which are not covered by ERISA or similar laws.

III. ONLY THIS COURT CAN RESOLVE THE CONFUSINGLY DIFFERENT WAYS THAT THE STATES DEAL WITH PENSIONERS' CONSTITUTIONAL CONTRACT RIGHTS

Review by this Court is necessary to eliminate widespread disagreement among the states regarding the scope of the protection provided to public employee retirement systems by the federal Contract Clause. Although most states now treat their pension obligations as contractual, they cannot agree on the standards governing their ability to unilaterally modify their side of the deal. The brief allusion in the Petition (pages 25-26) to the fact that the state courts display confusion in dealing with the rights

of public pension plan members discloses only the tip of the iceberg.[27]

The degree of constitutional protection afforded the contractual pension rights of public employees vis-a-vis their employers varies substantially, ranging from none at all to full protection from any unilateral change without the consent of the beneficiary. In between is a construction of the Contract Clause that has been widely described as the "California Rule," [28] which provides that the Contract Clause of the federal Constitution protects state pension obligations, but nevertheless allows the state unilaterally to make reasonable modifications so long as the modification bears some material relation to the purposes of the system and requires any disadvantage to be accompanied by an offsetting advantage. Others say that an exception permitting modification exists only if it will enhance the actuarial soundness of the system. One state has attempted to incorporate parts of three different approaches to the contractual rights of pensioners. Minnesota, which first adopted the strict *Yeazell* theory barring

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[27] Note, *Public Employee Pensions In Times Of Fiscal Distress*, 90 Harv. L. Rev. 992 (1977):

> "according to a 1976 congressional task force, the 'unclear legal status of the participants' rights' has become a 'distinguishing characteristic of governmental pension plans.'"

R. G. Cohn, "Public Employee Retirement Plans—The Nature Of The Employees' Rights," 1968 Ill. L. Forum 32, stating:

> "The blunt fact is that the law [of public employee pension rights] is contradictory and confusing; more disturbingly it is immature, and, with few exceptions, it is based upon contrived and unconvincing logic.
>
> "Despite the contradictions there is a beguilingly deceptive facade of principle. The decisions abound in classic legal concepts. Thus the 'rights' are 'contractual' or 'vested' or 'noncontractual' and 'nonvested'; they are 'gratuities' or earned but deferred compensation'; and depending on the label which is conveniently appended, these 'rights' may or may not be subject to legislative modification."

[28] *See, e.g., Brazelton v. Kansas Public Employee Retirement*, 607 P.2d 510, 518 (Kan. 1980): "We think the California rule as it has evolved is as appropriate to safeguard the interests of government

unilateral changes,[29] thereafter adopted a promissory estoppel theory to protect the constitutional rights of pensioners.[30] Yet, it has determined just this year that there was *no* contract to maintain a pension plan at a level of actuarial soundness.[31] Cases further illustrating this confusion are summarized at Appendix B.

The confusion of these cases is now ominously exacerbated by the California court's decision in *Claypool v. Wilson* (Petition, Appendix A), for it threatens to legitimize efforts by public employers to use the employees' trust funds to balance their budgets. If *Claypool*'s invidious extension of the California Rule for applying the Contract Clause is not corrected, it will encourage other state and local governments to go and do likewise, knowing that their use of public pension funds to balance their budgets does not violate the Contract Clause. Such a governmental invasion of pension funds poses a threat both to the retirement savings of pensioners, and to the pockets of future taxpayers, who must pay later for the underfunded promises of today.[32]

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and its employees in the State of Kansas as in the state of California."

Mullett v. City of Huntington Police Pension Board, 413 S.E.2d 143, 150 (W. Va. 1991) (referring to "what has been recognized as the 'California Rule' ").

Pensions: Public Employee Pension Plans as Contractual Obligations Granted Constitutional Protection, 20 Washburn L.J. 169, 177 (1980), describing the "California rule" and concluding it is "the better approach."

[29] *Sylvestre v. State*, 214 N.W.2d 658 (Minn. 1973).

[30] *See Christensen v. Minneapolis Municipal Employees' Retirement Board*, 331 N.W.2d 740, 750-751 (Minn. 1983) (quoting *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 412 (1983)).

[31] *See Minneapolis Teachers Retirement Fund Ass'n v. State*, 15 Employee Benefits Cas. (BNA) 2289 (Minn. App. 1992), *review denied.*

[32] See citations at note 12, *supra.*

The confusion is likely to spread elsewhere because California's interpretation of the Contract Clause is followed throughout the country. Jurisdictions that have followed and applied the California Rule, or referred to it with approval, include: Alaska, Colorado, Idaho, Kansas, Maryland, Massachusetts, Nebraska, Nevada, Pennsylvania, Vermont, Washington and West Virginia. A list of many of those cases, demonstrating the influence of the California Rule in other jurisdictions, is appended as Appendix C, including citations and brief summaries of the cases.

The lesson of these cases is that, if the decision below (*Claypool v. Wilson*, Petition, Appendix A) is allowed to stand, and the use of pension trust funds solely to balance a state's budget is permitted over a Contract Clause challenge, other jurisdictions throughout the United States that follow California, or approve the modified contract principle originating in that state, or adhere to a less binding rule, will now enthusiastically follow *Claypool*'s lead and invoke it to provide help in times of financial crisis, in violation of contractual rights of pensioners.

CONCLUSION

The size, omnipresence and importance of state and local public pension trust funds underscore the general significance of this case. Moreover, because California case law has so strongly influenced the public pension law of other states in determining the application of the Contract Clause to pensioners' rights in these trust funds, the decision below will have far-reaching bad consequences unless corrected. The increasing frequency of governmental efforts to use these funds for other purposes or otherwise to abdicate their responsibility to meet their pension commitments in favor of current budget-balancing, demonstrates the need for a consistent constitutional analysis to prevent abrogation of those commitments solely to avoid the difficult decisions necessary to balance budgets. The hodge-podge of approaches that now exists

among state courts produces an uncertainty about the future security of public pension funds that can only be stabilized by the intervention of this Court in this case.

The danger that habitual invasion or other use of pension trust funds for operational needs of the employer will continue or increase under the rule of *Claypool* brings a real threat of diminished funding of pension obligations, with two probable results, both potentially disastrous:

(1) money will run out and the pensioners will be unprotected, like the fate that befell Studebaker workers in the 1960's;[33]

(2) money will run out and protected pensioners will turn to that era's taxpayers in the affected local or state jurisdictions, thus imposing a burden on those taxpayers who must ultimately pay for the promised retirement benefits if they are not properly funded.

For these reasons, the *amici curiae* have joined in this brief, urging the Supreme Court to grant certiorari.

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[33] D. Keating, *Pension Insurance, Bankruptcy and Moral Hazard*, 1991 Wis. L. Rev. 65, 73 n.39: "Prior to the enactment of ERISA, many employees lost their pensions completely due to pension plan failures. The most infamous example was Studebaker's inability to meet its pension commitments in the 1960s. . . . The incidence of such tragic cases helped to spur the passage of ERISA." See *Rettig v. PBGC*, 744 F.2d 133, 137 (D.C. Cir. 1984). But public plans are unprotected by ERISA. *See* 29 U.S.C. § 1003(b)(1).

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APPENDICES

APPENDIX A

LIST OF RECENT STATUTORY EFFORTS TO SOLVE LOCAL BUDGET PROBLEMS AT THE EXPENSE OF PUBLIC PENSION TRUST FUNDS

Arizona

Changes in Ariz. Rev. Code § 38-781.05 between 1985 and 1990, which reduced employer contributions by changing the actuarial computation methods from the "entry age normal cost" method to the "projected unit credit" method, a change that reduces current contributions but substantially increases later ones. A similar change was invalidated in the New York *McDermot* case, see page 4a below.

California

1991: In addition to the statute which is the subject of *Claypool v. Wilson* (see Petition, Appendix E, pp. 61a *et seq.*), the Orange County Board of Supervisors unilaterally reduced contributions to the Orange County Employees' Retirement Association by $12.4 million, drawing upon the pension fund's reserve. See Los Angeles Times (Orange County edition) July 28, 1991, part B, p. 1, col. 5 ("Orange County supervisors took $12.4 million that they do not yet have and used it to balance their proposed budget . . .").

Colorado

Colorado Firefighters: Colo. Rev. Stat. §§ 31-30-1014 (2)(b) and (5) reduce the amount of funds (1) contributed to the death and disability fund and (2) transferred to the pension fund to assist in retiring the unfunded liability.

Connecticut

June 5, 1991 Conn.Pub. Acts 191-3: The Legislature approved a $190 million reduction in the state's scheduled

contribution to the employees' retirement fund as part of a solution to the state's deficit.

District of Columbia

The mayor of Washington submitted a proposed budget for fiscal 1993 that requested an appropriation to pay the Retirement Funds $44 200,000 *less* than the amount certified by the Board, in violation of the D.C. Retirement Act section 142 (c)(2), D.C. Code section 1-722 (c)(2). The D.C. Retirement Board filed suit against the mayor (D.C. Superior Ct. No. 92-CA04615), but the matter was eventually resolved satisfactorily by Congressional appropriation in the full amount, despite the mayor's budget proposal to solve her budget problems by underfunding the retirement plan.

Illinois

In 1990 the legislature enacted a statute that allowed the Chicago Board of Education to divert a property tax levy, previously dedicated to the local teacher pension system, to the general education fund for the duration of labor agreement, with Chicago Teacher's Union (scheduled to expire 8-31-93). See *Chicago Tribune*, Nov. 30, 1990, CHICAGOLAND pg. 1: "In a 68-46 vote that included Republican support, the Democrat-dominated House followed the lead of the Senate two weeks ago in approving the proposal for the board to divert tax revenues, primarily earmarked for teacher retirement, to fund teacher pay increases during the next three years."

Illinois State Retirement Systems: P.A. 87-14, effective July 25, 1991. Before the enactment of this statute, the proceeds of the sale of properties which escheat to the state were required to be paid into a special "State Pension Fund" in the State Treasury, for the benefit of state-funded pension systems. The statute permitted the Governor (until July 1992) to transfer any money in this account instead to the general revenue fund. Acting

on this authority, the Governor transferred $21 million to the general fund. This transfer is currently being challenged in the Illinois Supreme Court. *See People ex rel. Sklodowski v. State*, Illinois Supreme Court No. 72451, Plaintiffs/Appellants' Opening Brief at 9, "Statement of Facts," stating in part:

> "This is an appeal of the lower court's refusal to enjoin the Governor from transferring $21 Million from the State Pensions Fund legally committed to reducing the unfunded deficit in the State Retirement Systems, to the General Revenue Fund (general spending).
>
> * * * *
>
> "The Governor and Legislature, for the fiscal years 1990 and 1991 alone, budgeted and appropriated approximately $528 million less than the minimum contribution required for those years by P.A. 86-273. In the 1992 appropriation the Defendants cut pension funding by at least $30 million, ensuring that the State will not meet the minimum required by P.A. 86-273. See Comptroller's press release, Exhibit 3 to Plaintiffs' Amended Brief in Support of Injunction Against Comptroller's Transfer of Money From State Pension Appropriations to General Spending, R.C128."

One of the two "Issues Presented for Review" in that brief is as follows:

> "Is the Governor's designation and direction to transfer $21 Million from the State Pensions Fund (whose monies are legally committed to be contributed to the State Retirement Systems) to the General Revenue Fund (for spending upon general state purposes) an invalid impairment of pension rights in violation of Art. XIII, § 5 of the 1970 Illinois Constitution, or an impairment of pension contract rights under the contract clauses of the federal and state Constitutions, and should the transfer be enjoined?

Louisiana

Act No. 1038 of the 1991 Regular Session of the Louisiana Legislature, amended various statutes relative to the Louisiana Public Retirement Systems' Actuarial Committee. The legislation changed the composition of the trustees' actuarial committee to include more political officers, granted all political officers (or their designates) voting power and removed the voting power of the actuaries selected by the membership; thus only one actuary (employed by the legislature) has voting power. The statute also deleted a previous provision requiring unanimity of all actuaries for any action; the actuarial committee now can take action without the consent of any actuary.

Maine

Chapter 591, H.P. 1393-L.D. 1979 provides for the "deapportionment" of $87 million in employer contributions from teachers' retirement and state General Fund employees' retirement.

New York

N.Y. C.L.S. Retire. & S.S. Act § 23 sought to divest public employees' contract rights by substituting for the long-estabished aggregate cost funding method the projected unit credit funding method, thus substantially reducing current years' contributions but increasing those in later years. This statute was invalidated by *McDermot v. Regan*, 587 N.Y.S.2d 533 (1992).

Texas

Teacher Retirement System of Texas: Article 21, SB 3, 72nd Texas Legislature, effective date: August 22, 1991. Delay in statutory June, July and August 1993 contributions until September 3, 1993, with interest. Legislation passed to delay state contributions during June, July and August, 1993, to September, 1993 (third delay in

the past decade), with interest at 8%. Also, reduced employer contribution rate to 7.31% (instead of the 7.47% that the trusts' actuaries determined to be appropriate); difference between the two rates was $40 million.

Vermont

1990 and 1991: Legislature approved state contributions of $18 million less than the amount requested by the pension fund trustees. *See* N.Y. Times article, n.23 *supra*, quoting the State Deputy Treasurer.

APPENDIX B

CASES ILLUSTRATING CONFUSION CONCERNING ABILITY OF LEGISLATURES TO MODIFY CONSTITUTIONALLY PROTECTED CONTRACTUAL RIGHTS OF EMPLOYEES IN PUBLIC PENSION PLANS

Widespread disagreement exists among the states regarding the scope of the protection provided to public employee retirement systems by the federal Contract Clause. Although most states now treat their pension obligations as contractual, they cannot agree on the standards governing their ability to unilaterally modify their side of the deal.

The degree of constitutional protection afforded contractual rights of public employees vis-a-vis their employers varies substantially, ranging from none at all to full protection from any unilateral change without bilateral agreement—*i.e.*, the consent of the beneficiary. The following cases illustrate four areas of confusion:

1. NO MODIFICATIONS PERMITTED WITHOUT BILATERAL AGREEMENT

Association of Pennsylvania State College & University Faculties v. State System of Higher Education, 479 A.2d 962 (Pa. 1984)—Challenged statute required all state employees to make an additional one and one-quarter percent (1¼%) contribution to the State Retirement System without any offsetting advantages. As to employees whose contractual rights were vested prior to the statute's enactment, the court found that the statute's "Constitutional infirmity . . . was clear," since it was a unilateral modification adverse to its members. Additionally, relying on both—*conflicting*—views expressed in *Catania v. Commonwealth of Pennsylvania*, 450 A.2d 1342 (Pa. 1982), p. 8a *infra*, the court held the "Conclusion that [the statute] is unconstitutional as applied to employees . . . whose retirement benefits had not yet vested . . . is also unavoidable."

Yeazell v. Copins, 402 P.2d 541, 544-47 (Ariz. 1965)—Court held that an employee's contractual rights to pension benefits arose "at the moment of entrance" into public employment and that those rights could not later be modified without the employee's assent.

Jimmie "Red" Jones, Auditor of the State of Arkansas v. James Orville Cheney, 489 S.W.2d 785, 790 (Ark. 1973)—Court determined that an employee who was eligible to retire prior to a modification that changed the terms of his pension system's service requirement (from 15 years combined service at three state agencies to 10 years service at any one of the same three agencies) would not be deprived of his pension on account of the modification; ruling based on proposition that Legislature cannot break the bonds of contractual obligations ("It was certainly not within the constitutional power of the legislature to enact legislation which operated retroactively so as to affect the contractual relationship between the Retirement System and [plaintiff] created before the passage of the [statutory change]." Court expressly distinguished Legislature's ability to amend plan with respect to persons entering retirement system after the amendment's enactment. *See* App. B, section 3, *infra*.

2. MODIFICATIONS PERMITTED IF DISADVANTAGE TO EMPLOYEES IS OFFSET BY COMPARABLE ADVANTAGE

Mullett v. City of Huntington Police Pension Board, 413 S.E.2d 143, 148, 149 (W.Va. 1991); Under the challenged statute, a longer and more definite period of military service was required to qualify for early retirement credit. The court distinguished between constitutional implications of modifications that affect retired employees ("The legislature may add to but not diminish benefits without running afoul of (the) constitutional prohibition against impairment of the obligation of a contract") and modifications that affect active employees ("[t]o survive constitutional challenge . . . legislative

modifications to a pension plan must be reasonable"). The court felt the proper measure of a modification's "reasonableness" is its effect on the system members as a group rather than on individual members. [*But cf. Sheffield*, p. 13a *infra*, basing result on effect on "particular employee" whose rights are involved.] Finding that the disputed fund was being protected from the potential draining effect of massive early retirement, it concluded the statute created no disadvantage to the active participants in the system.

Singer v. City of Topeka, 607 P.2d 467, 474-476, 487 (Kan. 1980)—Acknowledging that employees have contractual rights prior to actual retirement that are "subject to the protection afforded by the contract clause of the U.S. Constitution," the Court adopted the California rule permitting reasonable changes. The Court chose to measure the "reasonableness" of a change by its effect on employees as a group, and not by its effect upon an individual employee. Thus, it invalidated a statute retroactively requiring firemen and police officers to contribute 7% of their gross pay to the pension fund rather than the 3% previously required on the grounds that the increase was not accompanied by a comparable advantage.

Public Employees Retirement Board v. Washoe County, 615 P.2d 972, 974 (Nev. 1980)—Court started with view that "Public employment contracts are within the ambit of the contract clause;" then adopted a rule prohibiting modifications that would eliminate or substantially impair an employee's contractual rights. However, the court held that reasonable modifications to maintain actuarial soundness would be permitted as long as any disadvantage to employees was accompanied by comparable new advantages. Applying these criteria to a statute that removed existing employees from an early retirement provision, the court concluded that the statute's retroactive application was unreasonable.

Catania v. Commonwealth of Pennsylvania, 450 A.2d 1342, 1349, 1354 (Pa. 1982)—Court invalidated a freeze

on the "final average salary" used to determine retirement benefits for judges because it offered no comparable advantage to offset disadvantages but upheld reduction in benefits to judges because it was accompanied by comparable advantage in the form of proportional reductions in contributions. However, the court was unable to reach a decision on the constitutionality of applying the changes to judges who were not yet eligible for retirement. Three Justices felt that changes enhancing actuarial soundness of fund and offset by comparable new advantages were permissible. ("Changes can be applied . . . without violating . . . the United States Constitution."). The three other participating judges would have held any unilateral reduction of retirement benefits unconstitutional ("That such an approach might violate the U.S. Constitution . . . does not appear to present a problem for those who would deny summary judgment").

Halpin v. Nebraska State Patrolmen's Retirement System, 320 N.W.2d 910, 916 (Neb. 1982)—The court found that a statute which suddenly excluded leave payments, formerly included in pension calculations, impaired state patrolmens' contractual rights. The court then had to determine whether the impairment was forbidden by the Constitution since an "impairment is not necessarily unconstitutional. [I]t may yet pass constitutional muster if it is 'both reasonable and necessary' to 'serve an important public purpose.'" Because the statute served no "important public purpose" or "vital state interest," it was invalidated.

Burlington Fire Fighters' Ass'n v. City of Burlington, 543 A.2d 686, 690 (Vt. 1988)—Plaintiffs failed to show that legislation "created a constitutional impairment of their contract" particularly since requirement of retroactive contributions was offset by retroactive effect of increased benefits.

Brazelton v. Kansas Public Employees Retirement Sys., 607 P.2d 510 (Kan. 1980)—Invalidated retroactive appli-

cation of statute that eliminated interlocking of retirement contributions and benefits to social security contributions and benefits because it resulted in increased contributions without offsetting advantages, and thus was "an unconstitutional violation of the Contract Clause of the United States Constitution."

Opinion of the Justices to the House of Representatives, 303 N.E.2d 320, 321 (Mass. 1973). When asked by the House of Representatives whether "the enactment of [a specific bill would] destroy or impair the obligation of a contract protected by Article 1, section 10 of the Federal Constitution," the court replied that the bill, which increased, from 5% to 7%, employees' contributions to a state retirement system would, in the absence of any countervailing important public purpose, unreasonably diminished the members' rights to their retirement benefits which are protected by the Federal Constitution's impairment-of-contract clause.

3. MODIFICATIONS PERMITTED TO ENHANCE ACTUARIAL SOUNDNESS

Jones v. Cheney, 489 S.W.2d 785, 790 (Ark. 1973)—Court determined that an employee who was eligible to retire prior to a modification that changed the terms of his pension system's service requirement (from 15 years combined service at three state agencies to 10 years service at any one of the same three agencies) would not be deprived of his pension on account of the modification; ruling based on proposition that the Legislature may strengthen the actuarial fibers but it cannot break the bonds of contractual obligations ("It was certainly not within the constitutional power of the legislature to enact legislation which operated retroactively so as to affect the contractual relationship between the Retirement System and [plaintiff] created before the passage of the [statutory change]."

Blackwell v. Quarterly County Court of Shelby County, Tennessee, 622 S.W.2d 535, 542 (Tenn. 1981). Change

to the benefit base in a county retirement plan (from average of five highest consecutive years' salary or last 12 months salary to average of three highest years) that resulted in potential reduction in benefits for most employees upheld under "Pennsylvania" rule permitting reasonable modifications to enhance actuarial soundness as long as employees eligible to retire or already retired are not adversely affected. Contrast to California rule (*Allen*) requiring comparable advantage. *Illustrates Confusion*: First, the trial court following California rule held the modification unconstitutional. Then, the Court of Appeals, relying on Article 1, section 10 of the United States Constitution, applied strict principles of contract law and held that no changes could be made that were detrimental to any employee—whether of retirement age or not. Supreme Court ultimately ruled that both lower courts were wrong.

Simpson v. North Carolina Local Gov't Employees' Retirement System, 363 S.E.2d 90, 94 (N.C. 1987)—Court adopted rule that public employees' rights to retirement benefits are contractual. It then remanded for a determination of whether a statute that altered the method of calculating disability benefits "is violative of the Contract Clause because it is reasonable and necessary to serve an important state interest" because the trial court had not properly resolved the issue.

4. MODIFICATIONS WHERE RIGHTS BASED ON PROMISSORY ESTOPPEL

Christensen v. Minneapolis Municipal Employees Retirement Board, 331 N.W.2d 740, 747, 750 (Minn. 1983). The pensions of nine public employees, who had already retired and were collecting pensions, were suspended under a statute that imposed a new minimum age requirement (60) for eligibility. The court invalidated the statute, as to those nine employees, using the test developed by the Supreme Court "to determine when a contractual

impairment is unconstitutional" (*id.* at 750) and characterizing the employees' interest "in terms of promissory estoppel" (*id.* at 747).

Minneapolis Teachers Retirement Fund Ass'n v. State of Minnesota, 15 Employee Benefits Cas. (BNA) 2289 (Minn. App. 1992)—In determining whether a modification to the funding method for a state retirement plan was constitutional or whether it operated as a substantial impairment of a contractual obligation, the court first held that public employees have protectable rights to pension plan benefits arising from the doctrine of promissory estoppel, but then held that the contract contained no provision guaranteeing the actuarial soundness of the plan.

Contrast *Valdes v. Cory*, 189 Cal.Rptr. 212, 222 (Ct. App. 1983), where the California Court of Appeal did find a constitutionally protected implied right to an "actuarially sound pension system" despite the fact that "The current provisions of the retirement law contain no explicit legislative commitment to an actuarially sound system."

APPENDIX C

BELOW ARE SUMMARIZED CASES FROM STATES FOLLOWING OR APPROVING THE "CALIFORNIA RULE" OF FLEXIBLE COUNTERBALANCING CONTRACTUAL OBLIGATION AND REFERRING TO *Allen v. City of Long Beach*, 287 P.2d 765 (Cal. 1955) OR *Betts v. Board of Admin.*, 582 P.2d 614 (Cal. 1978) OR BOTH.

Alaska

1. *State ex. rel. Hammond v. Allen*, 625 P.2d 844 (1981)—Repeal, by referendum, of statute creating special retirement system for elected public officials does not affect rights of elected officials participating in system prior to its repeal from enjoying benefits of that system (citing *Betts* for proposition that contractual rights of members of public employment retirement systems are vested).

2. *Hammond v. Hoffbeck*, 627 P.2d 1052, 1057-58 (1981)—Statute that reduced the occupational disability benefits and occupational death benefits of public safety employees held invalid because it resulted in disadvantage to public safety employees without being accompanied by comparable new advantages (citing and following *Allen* and *Betts* for that proposition).

3. *Sheffield v. Alaska Public Employees Ass'n*, 732 P.2d 1083 (1987)—Employees' early retirement benefits may not be computed according to actuarial factors adopted after employment commenced, if such computation reduces employees' benefits (following, at 1086, requirement in *Hammond v. Hoffbeck* (and its citation to *Betts, supra*) that determination of diminution of vested rights be made on a case-by-case basis and that any diminution be accompanied by corresponding advantages to the particular employee whose own vested pension rights are involved).

Colorado

4. *Police Pension & Relief Board v. McPhail*, 338 P.2d 694 (1959)—Amendment to city charter provision that repealed escalator provision of police and fire departments pension system (retirees' pension increases geared to active officers' salary increases) could not be applied retrospectively to officers who had already retired before enactment of the amendment. (Citing and following *Allen*, which dealt with "exact" problem presented here, 695-96).

5. *Police Pension & Relief Board v. Bills*, 366 P.2d 581 (1961)—Held the same city charter provision at issue in *McPhail* inapplicable to named officers who retired after enactment of provision, including some who had not reached retirement age prior to provision's enactment, on grounds that changes having substantially adverse effect upon an employee's anticipated pension benefits, whether fully or partially vested, are prohibited (relying on *Allen*, at 584).

6. *City of Aurora v. Ackman*, 738 P.2d 796, 800-01 (1987)—Court upheld ruling that statute could not retroactively require firemen to serve five more years before becoming eligible for retirement benefits since adverse impact of statute was not offset by comparable advantage, relying on *Allen*.

7. *Peterson v. Fire & Police Pension Ass'n*, 759 P.2d 720 (1988)—Court upheld denial, to policemens' widows, of survivorship benefits under City plan based on their eligibility to receive lower benefits under state plan (City plan based on ½ of officer's salary v. State plan limited to ¼ of salary). Court relied on *Bills* (and, thus, *Allen*) for proposition that a monetary loss to participants can only be justified by a corresponding beneficial change in plan. Court found both a benefit to individual participants—the likelihood of receiving continued benefits of state plan outweighed the reduction in their monthly benefits—and a benefit to participants, generally—local funds considered less stable, less sound than state fund.

Delaware

8. *In re State Employees' Pension Plan*, 364 A.2d 1228, 1234-35 (1976)—Court adopted view that pension plan participants were entitled to protection against unreasonable modification of the plan. Court then held that statutes providing for invasion of pension fund to pay benefits to persons who were not plan participants violated constitutional prohibition of impairment of participants' contractual rights. ("The thrust of this argument seems to be that it is permissible to invade the Pension Trust Fund . . . so long as actuarial adjustments may be made by future State contributions thereto. But an impairment plus such provision for future repair does not meet the constitutional guaranty of the Contract Clause of the Federal Constitution. The improper invasion of a trust fund is not excused and made proper by such promises of restitution; and this is especially so when the promises are not binding upon the future General Assemblies which must execute them from year to year.")

Idaho

9. *Hanson v. City of Idaho Falls*, 446 P.2d 634 (1968)—Court upheld statute authorizing cities to establish Policeman's Retirement Funds, funded by employee deductions and municipal contributions. Court cited *Allen* for proposition that employee deductions constitute "compensation" because rights in plans are vested (635, 636).

10. *Nash v. Boise City Fire Department*, 663 P.2d 1105 (1983)—Court invalidated statute which retroactively applied a 3% cost of living adjustment cap for pension benefits on the ground that the statute disadvantaged public employees whose pensions vested prior to the passage of the statute and offered no comparable new advantages, citing and following *Betts* for that proposition.

11. *Deonier v. State Public Employee Retirement Board*, 760 P.2d 1137 (1988)—Disapproved retroactive

application, to named firefighters, of requirement that disability benefits be reduced by workers' compensation benefits as a violation of firefighters' contractual rights. As in *Nash*, court adopted *Betts* analysis. (1141, 1142).

Kansas

12. *Brazelton v. Kansas Public Employees Retirement System*, 607 P.2d 510 (1980)—Invalidated retroactive application of statute that eliminated interlocking of retirement contributions and benefits to social security contributions and benefits because it resulted in increased contributions without offsetting advantages, adopting rule stated in *Betts* (517).

13. *Singer v. City of Topeka*, 607 P.2d 467, 474-476 (1980)—Court invalidated statute retroactively requiring firemen and police officers to contribute 7% of their gross pay to pay the pension fund rather than the original 3% on the grounds that the increase was not accompanied by a comparable advantage (citing in support *Allen*).

Maryland

14. *City of Frederick v. Quinn*, 371 A.2d 724, 727 (1977): Court remanded unilateral divesting by city of police pension fund to determine if modifications were either balanced by comparable benefit to the employee or necessary for the public welfare, relying on *City of Downey v. Board of Admin. Pub. Emp. Retire. Sys.*, 121 Cal. Rptr. 295 (Ct. App. 1975).

Massachusetts

15. *Opinion of the Justices to the House of Representatives*, 303 N.E.2d 320 (1973). In an advisory opinion, the court held that a bill increasing, from 5% to 7%, employees' contributions to a state retirement system would, in the absence of any countervailing important public purpose, unreasonably diminish the state employees' vested rights to their retirement benefits and was thus presumptively invalid.

16. *Dullea v. Massachusetts Bay Transportation Authority*, 421 N.E.2d 1228, 1235 (1981)—Relying on *Allen* for public employer's right to make "reasonable modifications" to a plan, Court held that public agency's withdrawal, after only 37 days, of an enhanced benefit plan was reasonable since plan was too short-lived to create any vested interest.

Nebraska

17. *Halpin v. Nebraska State Patrolmen's Retirement System*, 320 N.W.2d 910, 916 (1982): Exclusion of leave payments from pension calculations resulted in disadvantage to policemen without comparable new advantage, citing *Singer v. City of Topeka* (*supra* p. 16a) for support, which in turn relied on *Allen*.

Nevada

18. *Public Employees Retirement Board v. Washoe County*, 615 P.2d 972 (1980): Court invalidated statute deleting investigators and university police officers from group of officers defined as being eligible for pension benefits, stating that the fact that affected employees would not have to contribute to the fund did not constitute a comparable advantage under *Allen* rule.

North Carolina

19. *Simpson v. North Carolina Local Gov't Employees' Retirement System*, 363 S.E.2d 90, 93 (1987)—citing *Allen*, court adopted contractual view of public pension plans. Case remanded for determination of whether change to formula for calculating disability retirement benefits was reasonable or necessary to serve an important public purpose.

Pennsylvania

20. *Catania v. Commonwealth of Pennsylvania*, 450 A.2d 1342, 1349, 1352 (1982)—Court invalidated a freeze

on the "final average salary" used to determine retirement benefits for judges because it offered no comparable advantage to offset disadvantages (citing *Allen*) but upheld reduction in benefits to judges because it was accompanied by comparable advantage in the form of proportional reductions in contributions. Court was evenly divided as to whether changes in retirement contracts of judges who were not yet of retirement age violated the Contracts Clause. Three Justices felt that changes enhancing actuarial soundness of fund and offset by comparable new advantages were permissible. The three other participating judges would have held any unilateral reduction of retirement benefits to be unconstitutional.

21. *Harvey v. Retirement Board of Allegheny County*, 141 A.2d 197 (1958)—Holding that a statute which increased retirement age for employees dismissed for cause from age 50 to 60 constituted an actuarial change, the Court applied *Allen* and gave it retroactive effect, remanding only for a determination of the question of the cause of the employee's discharge.

22. *Association of Pennsylvania State College & University Faculties v. State System of Higher Education*, 479 A.2d 962 (1984)—Invalidated retroactive application of a statute that required all state employees to make an additional one and one-quarter percent (1¼%) contribution to the State Retirement System and had no offsetting advantages. Court relied on *Catania*, *supra*, as to both vested employees and non-vested employees, noting that the amendment was prohibited under either view expressed in *Catania*.

Vermont

23. *Burlington Fire Fighters' Association and Burlington Fire Fighters' Officers Association v. City of Burlington*, 543 A.2d 686, 689 (1988)—Court upheld amendment to City's pension plan that required retroactive contributions to pension fund in exchange for increased benefits, citing *Allen* and *Bakenhus*, *infra*.

Virgin Islands

24. *Joseph v. Government of Virgin Islands*, 576 F. Supp. 1335 (D.V.I. 1983)—Judges who entered public service while statute enlarging their pension benefits was in effect were contractually entitled to receive benefits of that statute, even though statute was repealed 29 days after becoming effective and even though no judge ever made contribution to pension fund established by statute. Court cited *Betts* for proposition that contractual pension expectations are measured by benefits in effect not only when employment begins but which are conferred during the employee's tenure. It held that the judge's benefits could be enlarged but not diminished.

Washington

25. *Bakenhus v. Seattle*, 296 P.2d 536, 540, 541 (1956)—Court invalidated statute which amended pension benefits for police officers by limiting monthly pension payments to $125 per month because approximately ⅓ of monthly anticipated pension had been removed with no comparable advantage, citing *Allen* as authority.

26. *Vallet v. City of Seattle*, 459 P.2d 407, 411-12 (1969)—Adopting *Allen* rule, Court upheld, as reasonable, escalation provision that supplanted old fixed pension system, on ground that disadvantage of provision (escalator for Inspector's position was keyed to salary of Captain—a lower position) was outweighed by advantage (captain's salary would increase, over time, to level greater than salary of plaintiff, an Inspector, at retirement).

27. *Weaver v. Evans*, 495 P.2d 639, 648-49 (1972)—Relying on rule established in *Allen* and *Bakenhus*, court ordered governor, who had withheld funds allocated to retirement system to meet general funds' obligations, to release those funds to retirement system.

West Virginia

28. *Wagoner v. Gainer*, 279 S.E.2d 636 (1981)—Court invalidated statute which prevented retired judge from receiving pension increases based upon salary increases granted to active members of the judiciary since it unreasonably impaired rights of retired members and served no important public purpose, citing *Betts*.

29. *Mullett v. City of Huntington Police Pension Board*, 413 S.E.2d 143, 150 (1991): Court upheld statute redefining early retirement for policemen because pension funds were being protected for potential draining; thus, there was no disadvantage to pensioner, citing in support *Betts*.

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In The

Supreme Court of the United States

October Term, 1992

THE BOARD OF ADMINISTRATION OF THE PUBLIC EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF CALIFORNIA, et al.,

Petitioners,

v.

PETE WILSON, GOVERNOR OF THE STATE OF CALIFORNIA; GRAY DAVIS, STATE CONTROLLER OF THE STATE OF CALIFORNIA; KATHLEEN BROWN, STATE TREASURER OF THE STATE OF CALIFORNIA; AND THOMAS W. HAYES, DIRECTOR OF THE DEPARTMENT OF FINANCE, STATE OF CALIFORNIA,

Respondents.

On Petition For Writ Of Certiorari To Court Of Appeal, State Of California, Third Appellate District

BRIEF IN OPPOSITION OF RESPONDENTS GOVERNOR PETE WILSON AND DIRECTOR OF FINANCE THOMAS HAYES

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QUESTIONS PRESENTED

1. Whether a modification of pension rights that bears a reasonable relationship to the successful internal operation of a pension system and which is accompanied by comparable new advantages violates the Contracts Clause of the Constitution.

2. Whether the California Court of Appeal properly determined that the provisions of chapter 83, Statutes of 1991, infringed no state contract rights.

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No. 92-678

In The

Supreme Court of the United States

October Term, 1992

THE BOARD OF ADMINISTRATION OF THE PUBLIC EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF CALIFORNIA, et al.,

Petitioners,

v.

PETE WILSON, GOVERNOR OF THE STATE OF CALIFORNIA; GRAY DAVIS, STATE CONTROLLER OF THE STATE OF CALIFORNIA; KATHLEEN BROWN, STATE TREASURER OF THE STATE OF CALIFORNIA; AND THOMAS W. HAYES, DIRECTOR OF THE DEPARTMENT OF FINANCE, STATE OF CALIFORNIA,

Respondents.

On Petition For Writ Of Certiorari To Court Of Appeal, State Of California, Third Appellate District

BRIEF IN OPPOSITION OF RESPONDENTS GOVERNOR PETE WILSON AND DIRECTOR OF FINANCE THOMAS HAYES

STATEMENT OF THE CASE

1. Factual Background

The Public Employers Retirement System (PERS) is the pension program for California state employees and for employees of local agencies who contract with the System. PERS is a defined benefits pension plan: employee benefits are defined and determined by statute.

PERS annuitants are guaranteed an annual cost of living adjustment (COLA) from 2 to 6 percent. Petitioner PERS Board of Administration is a statutorily created body charged with administering PERS.

In 1982 the California Legislature enacted the first of three programs which authorized the PERS Board, on a permissive basis, to augment the purchasing power of retired PERS members. These programs were known respectively as the Boatwright plan[1] (Cal. Gov. Code, § 21232), the Investment Dividend Disbursement Account ("IDDA", Cal. Gov. Code, § 21235), and the Extraordinary Performance Dividend Account. ("EPDA", Cal. Gov. Code, § 21238.)

There is in the Public Employees Retirement Fund (PERF) a statutorily created Reserve Against Deficiencies which is funded from interest earnings in excess of those credited to member accounts. The IDDA-EPDA and Boatwright programs and the allowances paid therefrom were funded through transfers of money from the Reserve Against Deficiencies (RAD). These transfers were predicated on legislative findings that the supplemental benefits could be funded without jeopardizing the actuarial soundness of the pension system. Pet. App. 30a-31a.

The legislation establishing those supplemental purchasing power programs required the PERS Board and the State Controller to inform recipients that these benefits were not cumulative, were not part of their base

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[1] For the sake of clarity and simplicity, respondents will adopt petitioners' usage and omit further reference to the Boatwright benefit. (See Pet., p. 5, fn. 3.)

allowance, and may be available for only a limited period of time. Cal. Gov. Code, §§ 21232(c), 21235(d), 21238(d).

The IDDA-EPDA benefits were not defined benefits, and they were not actuarially-based: i.e., they were not funded on an actuarial basis, and the funds set aside for these programs were not used either to determine the actuarial soundness of the retirement system or to determine the rate of employer contributions.[2]

While these plans provided some assistance to some retired pensioners, they were of only limited duration because their funding depended on the contingency of extraordinary investment returns; there was no actuarial basis for continued funding of the benefits. In a November 1990 report by A. Foster Higgins & Co., the PERS Board's consulting actuary, it was estimated that funding for these supplemental programs would be completely depleted within 6 to 10 years. Respondent's Exh. 1, p. 1.

The PERS consulting actuary also noted that the IDDA-EPDA program was unusual because

> ". . . in the private sector and in most public sector pension plans, there has always been a broad consensus that all excess investment earnings are appropriately used to reduce employer contributions."
>
> "The reasoning behind the conventional treatment of excess earnings is simple. The

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[2] Higher employer contributions resulted from the supplemental purchasing power programs, however, because the funds set aside for these programs were not included in the calculation of employer contribution rates. See *City of Anaheim* v. *State*, 189 Cal.App.3d 1478, 1482-1483 (1989).

> employer makes a commitment to provide certain pension benefits, and the contributions it makes are fully affected by all plan experience – economic and demographic, and whether positive or negative. Employee contributions, if any, are fixed and are not affected by experience. Stated differently, the *employer* bears all the risk of adverse experience and, in return, receives the full benefits of any positive experience."

Exh. 1, pp. 20-21. Cf. *City of Anaheim* v. *State of California*, *supra*, 189 Cal.App.3d at 1482-1483.

Faced with an unprecedented fiscal crisis in 1991, the California Legislature enacted legislation which eliminated the IDDA-EPDA programs and substituted a new monthly supplemental retirement benefit which would provide retirees up to 75 percent of the purchasing power of their initial monthly retirement payments. The legislation provided that remaining funds in the former IDDA-EPDA accounts were to be transferred, until exhausted, to employer contribution accounts, to offset normal required employer contributions to the PERF. Cal. Stat. 1991, ch. 83. This legislation also transferred actuarial functions from the PERS Board to an independent actuary under a nonrenewable contract with the Office of the Governor. The Governor's nomination of the contract actuary is subject to legislative veto, and the contract actuary cannot serve successive terms. Section 42 of chapter 83 directs PERS employers to apply the savings from the use of IDDA-EPDA funds for the purpose of retaining or rehiring active PERS members who are otherwise subject to layoffs or reductions in their working hours. The Deputy Director of the Department of Finance estimated that, without the savings achieved through chapter 83, about

11,000 state workers would have been laid off. Dec. Suzanne Burton, Resp. Exh. 5.

On November 3, 1992, the California electorate approved Proposition 162, which, among other things, supersedes the actuarial provisions of chapter 83 and restores actuarial responsibility to the PERS Board. Opp. App. p. 1a.

ARGUMENT

I

THE COURT OF APPEAL CORRECTLY FOUND THAT MODIFICATIONS IMPLEMENTED BY CHAPTER 83 DID NOT CONTRAVENE THE CONTRACT CLAUSE BECAUSE, AS A FACTUAL MATTER, THE NEW BENEFITS WERE COMPARABLE TO THE OLD BENEFITS

The principal issue in this case is whether the Contract Clause of the United States Constitution precludes the State of California from replacing the IDDA-EPDA supplemental purchasing power programs with a comparable benefit program and using the funds from the IDDA-EPDA accounts to offset employer contributions to the retirement fund.

The United States Constitution prohibits any state from passing a law "impairing the obligation of contracts." U. S. Const., art. I, § 10. This provision has been held to apply to any enactment which carries the force of state law, including the state's own Constitution.

Not every change in a contract constitutes an impairment of the obligations of contracts, however. See *Stork* v.

State of California, 62 Cal.App.3d 465, 468 (1976) [133 Cal.Rptr. 207]. Nor does every impairment run afoul of the Contract Clause. This Court has observed,

> "Although the Contract Clause appears literally to proscribe 'any' impairment, . . . 'the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula.' [Citation.] Thus, a finding that there has been a technical impairment is merely a preliminary step in resolving the more difficult question whether that impairment is permitted under the Constitution."

United States Trust Co. v. *New Jersey*, 431 U.S. 1, 21 (1977) [52 L.Ed.2d 92, 109, 97 S.Ct. 1505]. An attempt must be made "to reconcile the strictures of the Contract Clause with the 'essential attributes of sovereign power,' . . . " *Ibid.* For example, "[m]inimal alteration of contractual obligations may end the inquiry at its first stage. Severe impairment, on the other hand, will push the inquiry to a careful examination of the nature and purpose of the state legislation." *Allied Structural Steel Co.* v. *Spannaus*, 438 U.S. 234, 245 (1978) [57 L.Ed.2d 727, 737, 90 S.Ct. 2716], fn. omitted.

The relevant principles have also been expressed another way:

> "The constitutional prohibition against contract impairment does not exact a rigidly literal fulfillment; rather, it demands that contracts be enforced according to their 'just and reasonable purport'; not only is the existing law read into contracts in order to fix their obligations, but the

> reservation of the essential attributes of continuing governmental power is also read into contracts as a postulate of the legal order. (*City of El Paso* v. *Simmons* (1965) 379 U.S. 497, 508 . . . ; *Home Building & Loan Assn.* v. *Blaisdell* [1934] 290 U.S. [398,] 428-429, 434-435. . . .) The contract clause and the principle of continuing governmental power are construed in harmony; although not permitting a construction which permits contract repudiation or destruction, the impairment provision does not prevent laws which restrict a party to the gains 'reasonably to be expected from the contract.' (*City of El Paso* v. *Simmons, supra,* 379 U.S. at p. 515. . . .) Constitutional decisions 'have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change.' (*Ibid.*; see 70 Dock. L.Rev. 524-34 (1966); 56 Colum. L.Rev. 251-270 (1956).)"

Allen v. *Board of Administration,* 34 Cal.3d 114, 119-120, Appeal Dism. 465 U.S. 1015 (1983).

Most cases brought under the Contract Clause turn on the existence and nature of the contract rather than upon a construction of the law which is said to impair it. *Indiana* ex rel. *Anderson* v. *Brand,* 303 U.S. 95, 100 (1938). The determination whether a contract exists, and its meaning, requires reference to state law. *Ibid.* When this Court is presented with a claim that a statutory scheme has created a contract, it will exercise independent judgment as to both the existence and meaning of the contract, but in doing so will grant deference to the decision of the highest state court which considered the matter unless that decision is "palpably erroneous" or "manifestly wrong." *Hale* v. *State Board,* 302 U.S. 95, 101 (1937)

[82 L.Ed. 72, 76, 585 S.Ct. 102]; *Phelps* v. *Board of Education*, 300 U.S. 319, 322-323 (1937) [81 L.Ed. 674, 677, 57 S.Ct. 483]. When both the existence of a contract and its terms have been determined by reference to state law, then it may be determined whether a subsequently enacted state law constitutes an impermissible impairment of contract under the federal Constitution.

In this case, the state Court of Appeal never determined whether any employees actually had vested rights in the IDDA-EPDA supplemental purchasing power programs, though the court held that only a limited group of employees – those who worked after January 1, 1989 before retiring – had even a colorable claim to such rights. The court *assumed*, for purposes of analysis, that this group had vested rights to IDDA-EPDA benefits (Pet. App. 20a), and it then explored and resolved associated factual questions in a manner which made further constitutional inquiry unnecessary. Operating under the assumption that this limited class of employees had a vested right to the IDDA-EPDA benefits, the court found that chapter 83 effected no unconstitutional impairment of vested contract rights because this legislation made only reasonable modifications to the Public Employees Retirement Law, while providing comparable new benefits. Pet. App. 20a-27a. This determination is consistent with the decisions of this Court and with controlling California law.

Under California law, public employee pension benefits are not viewed as absolute or immutable, even where they are clearly vested and contractual in nature. "Not

every change in a retirement law constitutes an impairment of the obligations of contracts, however. Nor does every impairment run afoul of the contract clause." *Allen* v. *Board of Administration, supra,* 34 Cal.3d at 119, citations omitted. Rather, modifications – even extensive changes – are permissible:

> "The rule permitting modification of pensions is a necessary one since pension systems must be kept flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system and carry out its beneficent policy."

Kern v. *City of Long Beach,* 29 Cal.2d 848, 854-855 (1947); and see *Abbott* v. *City of Los Angeles,* 50 Cal.2d 438, 447-448 (1958); *Allen* v. *Board of Administration, supra,* 34 Cal.3d at 120.

The test for whether such pension modifications are valid is set forth by the California Supreme Court in *Allen* v. *Board of Administration, supra,* 34 Cal.2d at p. 131:

> "Such modifications must be reasonable, and it is for the courts to determine **upon the facts of each case** what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages. [Emphasis added.]"

Assuming, as the Court of Appeal did, that the elimination of the IDDA/EPDA programs was a modification affecting vested contract rights, the question is whether

the alterations were materially related to the theory of the pension system, and whether chapter 83 provided "comparable new advantages." Factually and legally, the decision of the Court of Appeal properly resolves this question against petitioners.

The Court of Appeal did not hold that a state's interest in "saving money," without more, is a sufficient basis for impairing contract rights. Quite the contrary, the court required *both* a theoretical justification for the changes in pension rights, related to the internal operation of the system, *and* a factual showing that any resultant disadvantage to employees is accompanied by comparable new advantages:

> "The saving of public employer money is not an illicit purpose if changes in the pension program are accompanied by comparable new advantages to the employee. If that were not the case the reasonable modification doctrine would add little flexibility to the administration of the public pension systems. The 'material relation' requirement fulfills 'the purpose of keeping the pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. . . .
>
> ". . . .
>
> "*Wallace* and *Allen* show that considerations external to the functioning of the pension system, such as increased taxpayer hostility to felons or jealousy of employees not covered by the system will not justify a change. The justification must relate to considerations internal to the pension system, e.g., *its preservation or protection or the advancement of the ability of the employer*

> *to meet its pension obligations.* Changes made to effect economies and save the employer money do 'bear some material relation to the theory of a pension system and its successful operation. . . . ' (*Betts* v. *Bd. of Administration, supra,* 21 Cal.3d at p. 864.) *That is not to say that a purpose to save the employer money is a sufficient justification for change. The change must be otherwise lawful and must provide comparable advantages to the employees whose contract rights are modified. We hold only that, the monetary objective will not invalidate a modification which is otherwise valid."* (Emphases added.)

The court below clearly took pains to fashion a limited holding which was consistent with prior decisions restricting the application of the reasonable modification doctrine. This decision clearly requires public entities to show more than a desire to save money before they can justify changes in pension laws. Furthermore, contrary to petitioners' assertions, the decision breaks no new ground regarding permissible pension modification. Under California law, fiscal considerations can be used as a basis for justifying changes in pension plan benefits. *Allen* v. *Board of Administration, supra,* 34 Cal.3d at 125. Indeed, it is patently absurd to argue, as petitioners do, that the continued solvency of the employer is immaterial to the continued vitality of the pension system.

Petitioners erroneously assert that the Court of Appeal's decision "impermissibly compresses" constitutional inquiry by omitting any inquiry into the "necessity" for the modification of pension benefits. Their claim wrongly assumes that a reasonable modification with

comparable new advantages is tantamount to an impairment of contract rights. This is not the case. Pension rights are created *subject to* the reasonable modification doctrine.

Even if reasonable modifications were to be construed as contract impairments, a detailed inquiry into the necessity of chapter 83 was not required here because the existence of the State's $14 billion dollar budget shortfall, and the State's overriding interest in closing this shortfall, were never seriously contested or challenged in this case. Given the context of this case, it is fanciful to argue that the *Claypool* decision modified the existing *standard* for measuring the constitutionality of impairments of contract obligations – a proposition that was never presented to the court and was not decided by the court. Rather, petitioners' challenge, there and before this Court, is more simply a dispute about the *factual propositions* (1) that chapter 83 was materially related to succsesful operation of the pension system, and (2) that elimination of the former IDDA-EPDA programs was accompanied by comparable new advantages.

To be sure, petitioners fault the Court of Appeal's analysis of the comparability of the old and new benefits. However, the comparability issue is essentially a factual question determined by the Court of Appeal in its exercise of original jurisdiction after considering extensive expert testimony on the subject. There is ample evidence in the record below to support the court's factual determination that the new benefits were indeed comparable to the old benefits.

Chapter 83 replaced the nonvested, temporary, discretionary, funded-by-chance IDDA/EPDA programs with a *vested* purchasing power protection program (PPPP), as set forth in newly added Government Code section 21235.5. The new program thus provides a guaranteed annual funding source,[3] while IDDA/EPDA adjustments were "funded" only when and if the investment market produced unexpectedly high earnings. And this new program provides for funding every year, permanently into the future, while the IDDA-EPDA reserves would have dried up completely in a matter of 6 to 10 years. A. Foster Higgins & Co. Report at p. 016, Resp. Exh. 1. Not only did the PPPP eliminate the contingent nature of the IDDA-EPDA benefits, but respondents' evidence further showed, with expert actuarial analysis, that the PPPP benefits equaled or exceeded the IDDA-EPDA benefits under various projected economic scenarios.[4] See generally 1st Bleakney Decl. at ¶ 5.10 et seq., Resp. Exh. 6

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[3] Further funding for the AB 702 PPPP is provided under section 29.5 of the bill, which added Government Code section 20652.5. Section 20652.5 reduces (prospectively) to 6 percent the interest rate credited on accumulated contributions for members who withdraw their contributions before qualifying for retirement. Section 20652.5 then provides for transfer to the PPPP of "[t]he interest amount which would have been otherwise credited to the member's account on or after the effective date of this section, but for the return of the member's accumulated contributions." See also Bleakney Decl. at ¶ 5.10, Resp. Exh. 6.

[4] A central irony in this case, ignored in the petition for writ of certiorari, is the fact that the PERS Board itself proposed complete elimination of the EPDA increases – and redirection of the accumulated IDDA-EPDA funds – as a way to address the fiscal crisis facing the State. Resp. Exh. 7, Objective No. 1.

and 2nd Bleakney Decl., Resp. Exh. 13. Although specifically requested by the Court of Appeal to compare the impact of the new mandatory second tier retirement program for new state employees on projected PPPP and IDDA-EPDA benefits, the petitioners below and the PERS Board (petitioner here) either declined to submit that evidence on this matter or submitted only sketchy evidence. Pet. App. 24a-25a and fn. 4 at p. 25a. Respondents submit that the failure of the petitioners and the PERS Board to avail themselves of the opportunity presented to them by the Court of Appeal precludes them from now relitigating this matter in Certiorari proceedings and from challenging the Court of Appeal's analysis of this complex factual question.

In any event, there is substantial evidence in the record to support the Court of Appeal's determination that the chapter 83 PPPP benefits are comparable to the repealed IDDA-EPDA benefits. Both IDDA and the PPPP use 75 percent of initial purchasing power as the standard for triggering pension increases, but – contrary to petitioners' assertions – IDDA was the relatively "illusory" benefit. As noted above, IDDA conferred no vested rights, had no guaranteed funding, was subject to the PERS Board's discretion, and would very probably have run out of monies in 6 to 10 years in any event. The PPPP, in contrast, is a permanent program with guaranteed funding sources; moreover, it confers upon members a vested contractual right to benefits. It is thus an *improvement*, not merely a comparable advantage (Bleakney Decl. at ¶¶ 5.70-5.72, Resp. Exh. 6), and it plainly "relate[s]

generally to the benefit that has been diminished." *Betts* v. *Board of Administration*, 21 Cal.3d 859, 864-865 (1978).

Petitioners argue that the PPPP benefits are obviously below the level of the repealed EPDA program, which authorized additional increases up to 80 percent of initial purchasing power, *provided there were sufficient funds to pay IDDA benefits*. Petitioners' insistence on strict numerical equality is not supported by the law, and ignores essential distinctions between IDDA/EPDA and the new program. A modification is permissible so long as there is *general comparability* of advantage; the doctrine would be meaningless if the Legislature were required to reinstate precisely the same program it repealed. EPDA opened the possibility that some increases in excess of 75 percent might be paid if the market generated extraordinary interest earnings and if the administrators determined that such increases were appropriate. But there was no vested right to such increases, and there was no guarantee that such increases would be paid out, as reflected in the PERS Board's express willingness to discontinue EPDA payments after January 1992.[5] See PERS Bd. Pres. 6/17/91 letter, Objective No. 2, Resp. Exh. 7. And, once again, PERS consultants estimated that, in any event, the monies available for such payments would be exhausted within 6 to 10 years. Resp. Exh. 1 at p. 016.

Petitioners may not concede that the permanent funding and vested right conferred by the PPPP are

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[5] It should be noted that payments under EPDA were not even authorized before January 1, 1991 (Gov. Code, § 21238(b)), and that only one EPDA payment was ever made. Lund Decl., Petitioners' Exhs. at p. 154.

improvements over the short-term, ad hoc EPDA program, but it is irrefutable that the PPPP creates, at the least, a comparable new advantage. Bleakney Decl. at ¶¶ 5.70-5.72, Resp. Exh. 6.

There is another distinct new advantage created by AB 702 which should be considered in the comparability analysis. Under section 42 of the bill, PERS members who are subject to layoff or reduction are afforded protection with respect to employers' expenditure of savings flowing from repeal of the IDDA/EPDA programs:

> "In expending any savings which accrue to [PERS] employers as a result of the repeal of the retirement allowance adjustment programs established pursuant to Sections 21235, 21236, 21237, and 21238 of the Government Code, the state, school districts, cities, counties, local districts, agencies, and any other [PERS] employers, shall give the highest priority to retaining or rehiring as many as possible of those [PERS] members subject to layoff or reduction."

This addition advances the twin purposes of protecting the very livelihoods of current PERS members and ensuring their continued participation in (and contributions to) the fund.

Neither the retirement system nor its membership are well served by massive layoffs and staff reductions among member employers. Current, active employees are members and beneficiaries of the system as much as retirees are, and the protection afforded by section 42 of chapter 83 is indeed a new advantage which benefits them and which must be assessed in determining comparability – at least to the extent

that current employees, and/or their unions on their behalf, purport to challenge the Legislature's actions concerning the IDDA/EPDA programs and accounts.

II

THE TRANSER OF IDDA-EPDA FUNDS TO ACTUARIALLY FUNDED RETIREMENT PROGRAMS VIOLATES NO CONTRACT RIGHTS AND DOES NOT INVOLVE ANY FEDERAL QUESTIONS

Petitioners urge this Court to review the lower court's determination that the provisions of chapter 83 for the transfer of IDDA-EPDA funds to the PERF, to be credited against employer contributions, do not violate the provisions of the California Constitution declaring PERF assets to be held in trust. Pet., pp. 19-22. The trust provisions of the California Constitution, by themselves, involve no federal questions. However, Petitioners contend that the trust provisions implicate contract rights because they were enacted in response to a 1982 attempt to use funds from the RAD to offset employer contributions. The same Court of Appeal which decided the *Claypool* case held the 1982 legislation to be an unconstitutional impairment of contract rights in *Valdes* v. *Cory*, 139 Cal.App.3d 773 (1983). Petitioners allege that certiorari review is necessary because the Court of Appeal misunderstood and wrongly applied its own *Valdes* decision in this case when it held that the fund transfer provisions of chapter 83 violated no contract rights. This argument is without merit, and certiorari should not be granted to review this issue because the state law issues were properly decided below. The fund

transfer provisions of chapter 83 raise no federal questions.

It is not the Court of Appeal but petitioners who have misinterpreted *Valdes* and who have failed to read it in its proper factual context. In *Valdes* there was only a limited record on the actuarial impact of the transfer of funds from the RAD to offset employer contributions, and the *Valdes* court invalidated the transfer because it was unable to determine whether the transfer impaired PERS members' implied contractual right to the actuarial soundness of PERS. *Id.* at 786. In this case, on the other hand, the legislative history of the IDDA fund, which contains actuarial findings that the IDDA fund could be created without impairing the financial integrity of the PERF, and the actuarial evidence presented by the parties – as well as the unique status of the IDDA-EPDA funds in the PERF – form the factual basis for the *Claypool* court's legal and factual determination that the use of these funds in lieu of general fund contributions posed no threat of impairment of members' vested rights in the security and integrity of the PERF and did not impinge on their right to the systematic funding of the PERF. Pet. App. 27a-31a.

The *Claypool* court's decision upholding the transfer of the IDDA-EPDA funds is based on a different record, on different facts, and on different statutes than the *Valdes* court's decision. The court's opinion here does not conflict with prior California decisions on the subject, and it is not an attempt to use state law to insulate Contract Clause claims from review by this Court. Certiorari should be denied for want of jurisdiction because

the redirection of IDDA-EPDA funds impaired no contract rights and raises no federal questions.

III

THE TRANSFER OF ACTUARY POWERS FROM THE PERS BOARD IS NOT A FEDERAL QUESTION, AND IS NO LONGER JUSTICIABLE IN ANY EVENT

Petitioners further argue for certiorari on the ground that chapter 83's transfer of actuarial responsibility from the PERS Board to an actuary appointed by the Governor unconstitutionally violates the putative contract right of California employees and retirees to have the PERS Board exercise actuarial duties for the System. Pet. pp. 22-25. This argument presents no legitimate federal question and, in light of the passage of Proposition 162 on November 3, 1992, the issue which it addresses is now moot.

Certiorari is unnecessary to review this issue because the Court of Appeal correctly applied California law to find that the Legislature had the power to transfer actuarial functions from the PERS Board to an actuary appointed by the Governor. This issue raises no federal contract clause question because, under the Constitution, the state has absolute power to create and modify subordinate agencies and offices.

This Court has consistently held that "the legislative power of a State, except so far as restrained by its own constitution, is at all times absolute to all offices within its reach. It may at pleasure create or abolish them, or modify their duties . . . (citations omitted)." *Higginbotham* v. *Baton Rouge*, 306 U.S. 535, 538 (1938). In California, the Legislature may exercise its legislative powers in any

manner which is not expressly or by implication limited by the California Constitution. Constitutional limitations on the legislative power are construed strictly, and are not to be extended to matters not covered by the language used. *Pacific Legal Foundation* v. *Brown*, 29 Cal.3d 168, 180 (1981); *California State Employees' Association* v. *State of California*, 199 Cal.App.3d 840, 845-846 (1988).

The PERS Board of Administration is a creature of statute, not of the Constitution, and when chapter 83 was enacted the Legislature had plenary powers over the Board and could confer upon it, or revoke or transfer from it, such powers as it saw fit. *Metropolitan Water District* v. *Whitsett*, 215 Cal. 400, 407 (1932). Thus the actuarial provisions of chapter 83 were properly found to be a valid exercise of legislative power and to have impaired no contract rights.

In any event, the question of the validity of chapter 83's transfer of actuarial powers from the PERS Board to a contract actuary is now moot because of the passage of Proposition 162 in the November 3, 1992 statewide general election. Proposition 162 amended section 17 of article XVI of the California Constitution to add subdivision (e), which provides:

> "(e) The retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system."

Proposition 162 is effective immediately upon certification of the official canvass by the Secretary of State. With

the passage of Proposition 162, the provisions of chapter 83 regarding the transfer of actuarial powers have effectively been repealed, and there is no longer a justiciable controversy over their transfer from the PERS Board. The matter is moot[6]. *DeFunis* v. *Odegaard*, 416 U.S. 312 (1974).

IV

THIS CASE RAISES NO FEDERAL ISSUES OF GENERAL IMPORTANCE THAT WARRANT REVIEW BY THIS COURT

Petitioners' final attempt to persuade this Court to grant review in this matter is a claim that review is necessary to resolve "issues of general importance" regarding the modification of public employee pensions. These issues revolve around the disparate approaches of the States in their treatment of the pension rights of public employees. However, any diversity that exists among the states in their treatment and characterization of the pension rights of public employees is the product of federalism and the freedom of the States to enact their own laws. This diversity in and of itself raises no federal questions because the Contract Clause is not a vehicle for establishing a federal common law of contracts.

The diverse state treatments of pension rights are proper in our federal system. They present no federal questions, and hence provide no jurisdictional basis for this Court to grant review in this case.

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[6] Although the Governor nominated a contract actuary, the Legislature never approved the Governor's nomination, and no actuarial rates were set pursuant to chapter 83.

CONCLUSION

The California Court of Appeal properly determined that the provisions of chapter 83 reasonably modified the existing supplemental puchasing power programs, impaired no rights under state law, and were reasonably related to the theory and operation of PERS. Since these modifications impaired no contract rights, they present no federal question warranting review by this Court. The remaining issues presented in the petition were properly resolved according to state law, and likewise raise no federal questions which would warrant review by this Court. Accordingly, respondents Wilson and Hayes respectfully request that the petition for writ of certiorari on file herein be denied.

DATED: November 17, 1992.

DANIEL E. LUNGREN
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Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1992

THE BOARD OF ADMINISTRATION OF THE PUBLIC EMPLOYEES RETIREMENT SYSTEM OF THE STATE OF CALIFORNIA, et al.,

Petitioners,

v.

PETE WILSON, GOVERNOR OF THE STATE OF CALIFORNIA, et al.,

Respondents.

On Petition For Writ Of Certiorari To The Third Appellate District, Court Of Appeal For The State Of California

BRIEF OF THE COUNTIES OF SANTA CRUZ, SANTA CLARA, RIVERSIDE, LAKE, SISKIYOU, YUBA, GLENN, DEL NORTE, PLUMAS, SIERRA, MARIPOSA MONO, HUMBOLDT, MADERA, SOLANO, SAN BENITO, SHASTA, AND NEVADA AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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Amici Curiae submit this brief as political subdivisions of the State of California in support of the Respondents.

INTEREST OF AMICI CURIAE

Amici Curiae SANTA CRUZ COUNTY, SANTA CLARA COUNTY, RIVERSIDE COUNTY, LAKE COUNTY, SISKIYOU COUNTY, YUBA COUNTY, GLENN COUNTY, DEL NORTE COUNTY, PLUMAS COUNTY, SIERRA COUNTY, MARIPOSA COUNTY, MONO COUNTY, HUMBOLDT COUNTY, MADERA COUNTY, SOLANO COUNTY, SAN BENITO COUNTY, SHASTA COUNTY, AND NEVADA COUNTY are counties and political subdivisions of the State of California.[1]

Each of the amici curiae has a direct and substantial interest in the validity of the legislation challenged by the petitioners. All of the amici curiae contract with the California Public Employees Retirement System ("PERS") to provide various levels of retirement benefits to their employees as specified in contracts between amici and the Board of Administration of PERS. The legislation challenged by the petitioners authorizes each of the amici to receive a credit against their obligation to make current contributions to the PERS fund from surplus monies

[1] Under Article XI, Section 1 of the California Constitution, counties are recognized as legal subdivisions of the State of California. The parties joining in this amicus curiae are designated counties under State law. California Government Code Section 23012.

which had been accumulated in the PERS fund. In accordance with the express intent of the legislation, this savings has been and is being used to avoid layoffs of public employees by amici which would otherwise be required if these surplus funds are not available as an offset against the current contribution obligations of amici to the PERS fund.[2]

INTRODUCTION

It is submitted that the petition filed herein does not present important questions of federal law to be settled by the U.S. Supreme Court, nor does the State Court decision in this case decide a federal question in conflict with another state's highest court or of a federal Court of Appeals.

BACKGROUND FACTS

Each of the amici provides retirement benefits to its employees through the Public Employees Retirement System as authorized by contracts between their boards of supervisors and the Board of Administration of PERS. In accordance with the provisions of California Government Code Section 20457, the PERS contracts, including the retirement plan of benefits, are negotiated with and approved by the employees of each contracting agency.

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[2] The savings to counties from the legislation is in excess of $143,000,000, as shown on an information sheet distributed by PERS, a copy of which is attached as Exhibit "A".

The Public Employees Retirement Law provides a base annual cost-of-living increase in retiree benefits of two percent pursuant to the provisions of Section 21224 of the California Government Code. In addition, each contracting agency had been authorized at their option to contract for a higher cost-of-living adjustment of retiree benefits, i.e., three percent, four percent or five percent by Section 21230 of the Government Code. Beginning in 1984, the State Legislature authorized the use of "excess" earnings on employee contributions to fund supplemental cost-of-living retiree benefit programs ("Boatwright", "IDDA", and "EPDA" programs). These supplemental cost-of-living benefits granted by the Legislature were extra-contractual, were not permanently funded, and the authorizing legislation expressly stated that these benefits may only be available for a limited period of time and/or contingent on the availability of funds. The legislation in question, Assembly Bill 702 adopted by the State Legislature on June 28, 1991, and signed by the Governor on June 30, 1991 as an urgency measure, repealed the IDDA and EPDA programs, provided for a credit of the surplus funds in IDDA and EPDA accounts against the future employer contribution obligations of participating public agencies, provided for the contracting of PERS actuaries by the Governor subject to the consent of the State Legislature, and directed the establishment of a new permanently funded cost-of-living benefit program for all retiree members of PERS.

The nature of the funding of PERS is central to any consideration of this case. Whereas the petitioners state that the prior supplemental cost-of-living benefit programs (Boatwright, IDDA, and EPDA) were funded by

"excess earnings on employee contributions" and that the PERS trust funds are to be used for the exclusive purpose of providing benefits, petitioners have failed to recognize that the contributions of employees and the earnings thereon are part of the funding of the benefits which the public employers have agreed to provide to their employees. As noted in *City of Sacramento v. Public Employees Retirement System* (1991) 229 Cal.App.3d 1470, 1478, fn. 5, the PERS plan is a defined benefit plan. Under PERS, both the employer and the employee are required to make contributions based on a percentage of "compensation", but whereas the employee's contribution rate is fixed, the employer's rate is adjusted annually after periodic actuarial analysis to provide the additional funds required to pay the defined benefits. *Id.* at 1479. The California Court of Appeal's decision in this case recognized that "ordinarily such earnings [on employee contributions] are accumulated to meet the basic pension obligations of the State and other PERS employers." 4 Cal.App.4th 646, 652. "Excess" earnings on employee contributions which should have been devoted to the payment of the benefits at the levels defined by the contracts of public employers (and thereby reduce the employer contribution rates) were instead diverted to pay for the Boatwright, IDDA, and EPDA supplemental cost-of-living benefits which local public employers did not contract to pay.[3] The legislation at issue allows public

---

[3] An employer providing a pension program also has contractual rights not to have its pension obligations increased. *Allied Structural Steel Company v. Spannaus*, 438 U.S. 234, 57 L.Ed.2d 727, 98 S.Ct. 2716 (1978).

employers to receive a credit against their current contribution obligations which appropriately offsets prior overcharges paid by the public employers.

ARGUMENT

POINT I

THE CALIFORNIA COURT HAS NOT DETERMINED THAT THE BOATWRIGHT, IDDA, AND EPDA SUPPLEMENTAL COST-OF-LIVING PROGRAMS CREATED ANY CONTRACTUAL RIGHT, AND THE LEGISLATIVE INTENT AND CIRCUMSTANCES INDICATE THAT NO CONTRACTUAL RIGHTS WERE CREATED.

In their petition, petitioners have failed to state the constitutional test for determining whether there is an impairment of the obligation of contracts within the meaning of Article I, Section 10 of the U.S. Constitution. As this Court has recently stated in *General Motors Corp. v. Romein*, 503 U.S. ___, 117 L.Ed.2d 328, 112 S.Ct. 1105 (1992), with regard to whether there is an impairment of obligation of contract under Article I, Section 10 of the Constitution:

> "This inquiry has three components: Whether there is a contractual relationship, whether a change in law impairs that contractual relationship and whether the impairment is substantial."

It is further stated by this Court in *Energy Reserves v. Kansas Power and Light*, 459 U.S. 400, 74 L.Ed.2d 569, 103 S.Ct. 697 (1983):

> "The threshold inquiry is 'whether the State law has, in fact, operated as a substantial impairment of a contractual relationship' (citations). The severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected (citations) . . . on the other hand, State regulation that restricts a party to gains reasonably expected from the contract does not necessarily constitute a substantial impairment." 459 U.S. at 411; 74 L.Ed.2d at 580.
>
> . . .
>
> "It is only if the State regulation constitutes a substantial impairment does the Court reach the issue of whether the State in justification had a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem." 459 U.S. at 411-412; 74 L.Ed.2d at 581.

It is further stated by this Court in *General Motors Corp. v. Romein, supra,* 117 L.Ed.2d at 337:

> "We 'accord respectful consideration and great weight to the views of the State's highest court', but ultimately we are 'bound to decide for ourselves whether a contract was made'."[4]

It is undisputed that under California law employees generally acquire a contractual right to pensions, i.e.,

---

[4] Although petitioners quote the clause referring to the duty of the Court to independently determine whether there is a constitutional impairment of contract, they omit the first part of the Court's statement that the Court is to "accord respectful consideration and great weight to the views of the State's highest court". *Indiana, ex rel. Anderson v. Brand,* 303 U.S. 95, 100 (1938).

Olson v. Cory (1980) 27 Cal.3d 532, 540; *Betts v. Board of Administration* (1978) 21 Cal.3d 859, 863. However, the question addressed in this case is not whether an employee has a contractual right to a public pension, but whether employees acquired contractual rights in the particular supplemental cost-of-living benefits which were granted by the State Legislature on an extra-contractual basis to members of PERS and on the express basis that those benefits were temporary and/or subject to the availability of funds.

The California Court of Appeal's decision in this case assumed for the purposes of its opinion that the legislation providing for the supplemental cost-of-living benefits (IDDA and EPDA benefits) established contractual rights. However, the Court expressly did not rule on that issue. 4 Cal.App.4th at 660 and 665. Without deciding the threshold issue, the Court of Appeal moved to the issue as to whether the legislation abolishing the prior supplemental cost-of-living benefit programs and allowing the credit of the surplus funds against employer contributions, and the replacement of that program with a permanently funded cost-of-living program provided a comparable benefit so as not to result in a substantial impairment of contractual rights. The Court of Appeal concluded that the new COLA program provided an obvious new advantage in that it granted "actual benefits for the theoretical but illusory higher benefits under the repealed programs." *Id.* at page 660. The Court concluded that "no contract rights are impaired". *Id.* at page 652.

The legislative intent and the legislative language and circumstances surrounding the adoption of the supplemental cost-of-living benefits are pivotal in determining whether a contractual right has been created. As stated in *U.S. Trust v. New Jersey* 431 U.S. 1, 17, fn. 14 (1977):

> "In general, a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State."

In *National Railroad Passenger Corp. v. Atchison, Topeka and Santa Fe Railroad Company* 470 U.S. 451 (1985), this Court rejected a challenge to a federal law under the contracts clause because "neither the language of the statute nor the circumstances surrounding its passage manifests any intent on the part of Congress to bind itself contractually. . . . " *Id.* at 470. The Court further noted that there is a presumption against contractual rights being created in State laws and it is the burden of the challenger to overcome that presumption. *Id.* at 465-466.

A contractual right is also dependent on "reasonable expectations and consideration", *Energy Reserves v. Kansas Power and Light*, 459 U.S. 411, 74 L.Ed.2d 569, 580 (1983), and "legitimate expectations", *General Motors Corp. v. Romein*, 117 L.Ed.2d 328, 340 (1992). Similarly, under California law contractual rights under a pension plan depend on reasonable pension expectations. Cf. *Olson v. Cory* (1980) 27 Cal.3d 532, 540; *Betts v. Board of Administration* (1978) 21 Cal.3d 859, 863.

As noted by the decision of the Court of Appeal in this case, the legislation expressly stated that the IDDA benefits "may be available for only a limited period of time and that the Board may discontinue the increases", and also noted that the EPDA benefits were also provided on the basis that they "may be available only as a result of extraordinary returns to the system". 4 Cal.App.4th at 657.

The legislation for the so-called "Boatwright benefit", Section 21236 of the Government Code, required the following special notice to recipients:

> "The Board shall inform each recipient of benefits . . . that the increases are not cumulative and shall not be included in their base allowance and may be available for only a limited time."

With regard to the IDDA benefits, Government Code Section 21235 required the following special notice to recipients:

> "The Board shall inform each recipient of benefits . . . that the increases are not cumulative, not part of the base retirement allowance, and may be available for only a limited period of time, and that the Board may discontinue the increases."

With regard to the EPDA benefit, Government Code Section 21238 required the following special notice to recipients:

> "The Board shall inform each recipient of benefits . . . that the payments are not cumulative, not part of the base retirement allowance, and may be available only as a result of extraordinary investment returns to the system."

It would seem apparent from this statutory language and the circumstances surrounding its adoption that the intent of the Legislature was *not* to make these benefits part of the contractual pension rights of public employees but it was to grant an extra-contractual benefit to retirees which could be discontinued or replaced.

POINT II

THE CONTRACTUAL RIGHTS RECOGNIZED BY THE CALIFORNIA COURTS OF PUBLIC EMPLOYEES IN GOVERNMENT RETIREMENT PROGRAMS ARE NOT IMPAIRED BY REASONABLE MODIFICATIONS.

The California courts have only recognized the acquisition by public employees of limited contractual rights in retirement programs subject to the ability of the public agency to make reasonable modifications which provide comparable benefits. As stated by the California Supreme Court in *Betts v. Board of Administration, supra,* at 863-864:

> "A long line of California decisions has settled the principles applicable to the problems herein presented. A public employee's pension constitutes an element of compensation, and a vested contractual right to pension benefits accrues upon acceptance to employment. Such a pension right may not be destroyed, once vested, without impairing a contractual obligation of the employing public entity (citation). The employee does not obtain, prior to retirement, any absolute right to fixed or specific benefits, but only to a "substantial or reasonable pension" (citation).
>
> . . .

> "However, there is a strict limitation on the conditions which may modify the pension system in effect during employment. We have described the applicable principles as follows: 'An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system (citations). Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages (citations) . . . '."

Accordingly, if the modification of a California government retirement program meets the reasonable comparability test developed by the California courts, then there has been no impairment of any contractual rights recognized under California law.

As indicated hereinabove, the California Court of Appeal determined that the permanently funded, new supplemental cost-of-living benefit program provided a comparable benefit to the theoretical but illusory higher benefits under the repealed programs, and therefore no contract rights were impaired. The Court of Appeal's application of the established principles of California law pertaining to the modification of government retirement programs is entitled to great weight.

POINT III

EVEN IF IT IS ASSUMED THAT CONTRACTUAL RIGHTS WERE CREATED BY THE SUPPLEMENTAL COST-OF-LIVING BENEFIT PROGRAMS, AND THAT THE NEW LEGISLATION CONSTITUTED A SUBSTANTIAL IMPAIRMENT OF THOSE CONTRACTUAL RIGHTS, THE MODIFICATION WOULD STILL BE JUSTIFIED ON THE GROUNDS IT SERVED A SIGNIFICANT AND LEGITIMATE PUBLIC PURPOSE.

Under the U.S. Supreme Court decisions, the Court only reaches the issue of whether there was a significant and legitimate public purpose to support a regulation *if* the State regulation is determined to constitute a substantial impairment of contract. *Energy Reserves v. Kansas Power and Light, supra,* at 459 U.S. 411-12. Even assuming contractual rights are created, and that those rights are substantially impaired by legislation, the remedying of a broad and general social or economic problem may constitute a significant and legitimate public purpose justifying a substantial impairment of contract. *Energy Reserves v. Kansas Power and Light, supra* at 411-412. Petitioners repeatedly contend in their petition that the legislative action was "solely in order to save itself money" (Page 11), for the "express purpose of saving an employer money" (Page 14), and that "[I]ndeed if this money had simply been given to charity, employees would have been no worse off" (Page 22). These statements incredibly ignore the express purpose of the urgency legislation and the fiscal realities present in California which is in the midst of a deep recession. Section 42 of Chapter 83 of the 1991 Statutes stated:

> "In expending any savings which accrue to Public Employees Retirement System employers as a result of the repeal of the retirement allowance adjustment programs established pursuant to Sections 21235, 21236, 21237 and 21238 of the Government Code, the state, school districts, cities, counties, local districts, agencies, and any other public employees retirement system employers, shall give the highest priority to retaining or rehiring as many as possible of those Public Employees Retirement System members subject to layoff or reduction."

If anyone should recognize the reality of this statement, it should be the unions and associations which are petitioners in this action. Many of their members have already been laid off due to the fiscal crisis and any unavailability of the almost $2 billion at stake in this litigation to the State, counties, school districts and other public agencies contracting with PERS would result in a further layoff of substantial numbers of their members. The purpose of avoiding further layoffs of employee members of PERS by counties, cities and special districts throughout the State during this recession addresses the broad and general social and economic problems created by the recession, and it is a remedy which is directly related to the retirement system. Employees laid off who have not yet become vested in PERS would lose any rights to receive any benefits under either the supplemental cost-of-living benefit programs or under the basic retirement programs. Furthermore, even employees vested in PERS who are laid off prior to retirement age would possibly face the unpleasant choice of either "cashing out" their retirement contributions and thereby forfeiting all their retirement rights or trying to survive

without a paycheck while they seek other employment during a recession. It is extremely doubtful that any such employees would view "charity" as being an acceptable alternative to the loss of their jobs.

POINT IV

THE FACT THAT THE VARIOUS STATES USE DIFFERENT STANDARDS FOR DETERMINING WHETHER THERE HAS BEEN AN IMPAIRMENT OF CONTRACT IN THE MODIFICATION OF GOVERNMENT PENSIONS DOES NOT INDICATE A NEED FOR INTERVENTION BY THIS COURT.

Petitioners argue that this case raises issues of general importance and that it is necessary that this Court resolve the "confusion" and conflicts among State Courts on when government pensions can be modified.

This Court has long held that whether government pension programs are subject to modification (or abolition) is dependent on State law. *Dodge, et al. v. Board of Education of the City of Chicago, et al.*, 302 U.S. 74, 82 L.Ed. 57, 58 S.Ct. 98 (1937). Accordingly, the nature of the contractual rights, if any, of public employees in government pensions are to be determined state by state under their respective laws. In addition, this Court will accord respectful consideration and great weight to the determination of the State's highest courts on whether contractual rights have been created. *Indiana, ex rel. Anderson v. Brand, supra,* and *General Motors Corp. v. Romein, supra.* As noted hereinabove, under California law, public employees only acquire limited contractual rights in a government retirement, subject to the ability of the public agency to modify the pension program so as to provide

comparable benefits. Moreover, the supplemental cost-of-living benefits at issue in this litigation are unique in that they were extra-contractual, expressly limited in time and/or contingent on the availability of funds, and recipients were specifically advised these benefits were uncertain and not part of their base retirement allowance.[5]

Indeed, as discussed hereinabove, there has been no determination by the California courts that these unusual supplemental cost-of-living benefit pension programs even created any contractual rights.[6] Accordingly, this

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[5] The decision of the Court of Appeal in this case is also consistent with the recent decision of the Court of Appeal in *Walsh v. Board of Administration of the Public Employees' Retirement System* (1992) 4 Cal.App.4th 682 (Petition for Review denied by the California Supreme Court on June 11, 1992, and a Petition for Writ of Certiorari rejected by the U.S. Supreme Court on November 9, 1992.) In that case, the Court of Appeal found that a member of the State Legislature did not have any contractual rights to an extraordinary benefit granted during a time when the Legislature's retirement system was not an actuarially based pension, there was no continuous appropriation for the payment of those benefits, and the Legislature had the reserved power to limit benefits. Similarly, in this case the Boatwright, IDDA, and EPDA benefits were not part of the actuarially based retirement plan, there was no permanent funding for the payment of those benefits, and the authorizing legislation expressly stated that the benefits may be available for only a limited period of time and/or were contingent on availability of funds.

[6] The additional issue raised by petitioners regarding the legality of the transfer of the authority to hire actuaries from the PERS Board of Administration to the Governor has become moot for the reason that a statewide initiative (Proposition 162) was approved by the voters on November 3, 1992, restoring this authority to the PERS Board.

case does not present any issue ripe for determination by the Court, nor is the unusual nature of the programs at issue herein likely to be replicated in other states so as to warrant review of the determinations of the State Court of Appeal. It is neither necessary nor appropriate in light of the long-standing judicial precedent to attempt to resolve the various positions of the states with regard to modification of government pensions.

CONCLUSION

For the reasons stated, the Petition for Writ of Certiorari does not raise substantial questions of federal law which need to be settled by this Court, nor does the decision of the State Court conflict with any of the prior decisions of this Court or of other States' highest courts or of any federal Court of Appeal.

Dated: November 18, 1992

Respectfully submitted,
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EXHIBIT A

County	Credit
Alpine	$167,847
Amador	1,023,421
Butte	3,516,265
Calaveras	853,109
Colusa	842,458
Del Norte	658,800
El Dorado	3,332,192
Glenn	962,374
Humboldt	4,251,610
Inyo	1,062,152
Kings	2,934,920
Lake	1,495,585
Lassen	776,705
Madera	1,883,748
Mariposa	497,415
Modoc	496,088
Mono	831,897
Monterey	9,467,840
Napa	3,380,990
Nevada	1,763,885
Placer	4,405,442
Plumas	917,815
Riverside	22,858,533
San Benito	701,603
Santa Clara	44,710,957
Santa Cruz	6,346,651
Shasta	3,886,567
Sierra	260,841
Siskiyou	1,790,165
Solano	6,444,657
Sutter	1,955,896
Tehama	1,511,694
Trinity	40,437
Tuolumne	1,541,816
Yolo	3,962,303
Yuba	1,563,474
Total	$143,098,152

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On Petition for a Writ of Certiorari to the Court of Appeal of California Third Appellate District

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On Petition for a Writ of Certiorari to the Court of Appeal of California Third Appellate District

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REPLY BRIEF FOR PETITIONERS

The petition in this case raises three legal claims: (1) that the court below committed a fundamental constitutional error in holding that a State could impair its own contracts solely in order to save money; (2) that the State's expropriation of $1.9 billion of pension funds previously dedicated to pay cost-of-living adjustments (COLAs) for pensioners unconstitutionally impaired the State's pension contract with its employees; and (3) that the State's substitution of a politically appointed actuary for the independent PERS Board also was an unconstitu-

tional impairment of contract. As to the first two claims, respondents have simply failed to join issue, as we will demonstrate below. With respect to the third claim, we agree with respondents that it has become moot as a result of a California ballot initiative, passed on November 3, 1992, restoring actuarial authority to the PERS Board.

1. The California Court of Appeal in this case found that the State had changed its pension contract for only one reason—to "sav[e] [the] public employer money." Pet. App. 21a. The court then concluded that this "is not an illicit [constitutional] purpose." *Ibid.* That holding, as we demonstrated in the petition (at p. 12), squarely conflicts with this Court's decision in *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977), and its progeny in the federal courts of appeals. *See also Lynch v. United States*, 292 U.S. 571, 580 (1934) ("Congress [is] without power to reduce expenditures by abrogating contractual obligations of the United States"); *Perry v. United States*, 294 U.S. 330, 353-54 (1935) (same). This principle is so well established that the United States recently "concede[d] that the government may *not* alter contracts simply to save money." *Alpine Ridge Group v. Kemp*, 955 F.2d 1382, 1387 (9th Cir.), *cert. granted*, 61 U.S.L.W. 3367 (Nov. 16, 1992) (No. 92-551) (emphasis added).

Respondents have refused to come to grips with this fundamental constitutional error made by the court below. Like that court, respondents do not even address, much less attempt to distinguish, the discussion of legitimate and illegitimate purposes for contractual impairments in *United States Trust Co.* or other precedents. Instead, they contend, in the words of their argument heading, that "as a factual matter, the new [pension] benefits were comparable to the old benefits." Br. in Opp. 5. This argument, even if it were correct, which it is not (*see* p. 4 *infra*), would still be inadequate. To

pass constitutional muster a State must show not only that a unilateral modification of its own contract was "reasonable," but also that the change was "necessary to serve an important public purpose." *United States Trust Co.*, 431 U.S. at 25, 29. While "comparability" may say something about the reasonableness of a contract impairment, it says nothing about the necessity for such an action. The latter requirement can only be assessed in terms of the State's *purpose* for dishonoring its own contract—and here that purpose (saving governmental money) does not, as a matter of settled Contract Clause law, amount to necessity.[1]

Respondents mistakenly attempt to fashion a new constitutional standard, focused only on comparability, out of the statement in *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978), that "[m]inimal alteration of contractual obligations may end the inquiry at its first stage." Br. in Opp. 6. But, leaving aside the pointed use of the word "may" in that sentence, the *Allied Steel* decision only involved State modification of a contract between *private* parties. Indeed, the Court in *Allied Steel* expressly noted that application of the Contract Clause is "more stringent" when the State is a party to the contract. 438 U.S. at 244 n.15. In such a setting, as this

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[1]Ignoring the teachings of this Court's cases, and without citation or analysis, respondents blithely assert that "a detailed inquiry into the necessity of chapter 83 was not required here because the existence of the State's $14 billion dollar budget shortfall, and the State's overriding interest in closing this shortfall, were never seriously contested or challenged in this case." Br. in Opp. 12. This carefully worded statement cannot mask the fact that the *court below* completely ignored the "necessity" portion of the constitutional inquiry. In any event, as noted in text, respondents' suggestion that a State can abrogate its contracts because it faces a budgetary shortfall was squarely rejected in *United States Trust Co.*, where this Court ruled that such a view of "the Contract Clause would provide no protection at all." 431 U.S. at 26. Political convenience, which is what respondents are talking about, is not constitutional necessity.

case illustrates, concerns about the underlying purpose of the impairment are far more salient, because "the State's self-interest is at stake." *United States Trust Co.*, 431 U.S. at 26. *See also Perry*, 294 U.S. at 350-51 ("[t]here is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of Congress to alter or repudiate the substance of its own engagements").

The emptiness of respondents' one-dimensional constitutional focus on comparability is demonstrated by their insistence that the new benefit provided to petitioners is "comparable" to the one taken away from them. While predictable, such an argument must be viewed with considerable skepticism when it is being pressed by a State that stands to benefit financially by impairing its contract. From a constitutional viewpoint, of course, the critical consideration is that petitioners—whose contract right is being denied here—do *not* think the benefits are comparable. And, quite obviously, they are right in that judgment.

Indeed, given that the State's only reason for impairing its contract with petitioners was to save *itself* money, it is nothing short of remarkable that respondents were successful in persuading the court below to take the opposite view. After all, neither respondents nor the court below have attempted to explain how the State's expropriation of $1.9 billion, previously committed solely to pay the old benefits, could possibly leave petitioners in a "comparable" position when they received new contingent benefits funded without such reserves. Nor have they explained how *prospective* funding for the new benefits remained comparable when it was capped at 1.1 percent of employee assets—after a decade of experience with the old benefits during which funding consistently exceeded 1.5 percent of those assets. These unanswered questions show how utterly toothless respondents' comparability test really is.

Respondents also make a last-ditch effort to obscure the important constitutional question presented by arguing that the contract itself implicitly authorized what the State did here, and therefore was not impaired at all. Thus, respondents passingly suggest that the two-part reasonable-modification standard—requiring that a change in vested pension rights be materially related to the "theory and successful operation of a pension system" and be accompanied by "comparable new advantages" (*Allen v. Board of Admin.*, 665 P.2d 534, 538 (Cal. 1983))—is a part of the pension contract itself. Br. in Opp. 11-12. That contention rests on a serious misreading of the *Allen* case (*see id.* at 9), in which the California Supreme Court expressly held that this two-part test was based on "the contract clause [of the U.S. Constitution]." 665 P.2d at 535; *see also Betts v. Board of Admin.*, 582 P.2d 614, 619 (Cal. 1978) (failure to meet two-part test means pension modification "cannot *constitutionally* be applied") (emphasis added).[2] In short, the California rule that petitioners challenge cannot properly be viewed as an implicit part of the pension contract based on state law. It is, rather, a constitutional rule that merits review because it was unconstitutionally applied here to allow a State to violate its own contract obligation for the purpose of saving itself money.

2. In response to our second argument—that it violated the "exclusive-benefit" provision of the contract for the

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[2] Respondents quote an earlier statement in *Allen* to the effect that "[n]ot every change in a retirement law constitutes an impairment of the obligations of contracts." 665 P.2d at 537, *quoted in* Br. in Opp. 8-9. *See also* Br. in Opp. 5, 11-12. But, as the plain language in the *Allen* opinion makes clear, that statement does not apply when, as here, vested contract rights *are* at stake and the two-part constitutional rule governing the legitimacy of contract *impairments* applies. Indeed, the language from *Allen* that respondents rely on—which was *not* applied in that case—is followed by a cite to *Stork v. California*, 133 Cal. Rptr. 207 (Ct. App. 1976), a case holding that a reallocation of annual benefits over a retiree's lifetime, with no overall monetary loss, was an unconstitutional impairment.

State to expropriate $1.9 billion in PERS funds, which had been earned solely on employee contributions and had already been dedicated to pay employee COLA benefits, for the purpose of paying future employer contributions to the program—respondents misstate our position and then proceed to rebut the position as misstated. According to respondents, "[p]etitioners allege that certiorari review is necessary because the Court of Appeal misunderstood and wrongly applied its own *Valdes* [*v. Cory*, 189 Cal. Rptr. 212 (Ct. App. 1983)] decision in this case." Br. in Opp. 17. But what *we* alleged is something very different: that the State's maneuver here "contravene[d] petitioners' contract right to have PERS trust funds used 'for the exclusive purposes of providing benefits to participants . . . and defraying reasonable expenses of administering the system.'" Pet. 8 (quoting Cal. Const. art. XVI, § 17(a)).

This state constitutional prohibition, when adopted in 1984, was reinforced by an explicit statutory prohibition against the use of trust funds for any purpose other than administrative costs, investments and benefits in former Cal. Gov't Code § 20203.3. Pet. App. 56a. Recognizing this statutory bar to its use of trust funds for its own purposes, the legislature, in Chapter 83, amended section 20203.3 so that it now reads:

> Notwithstanding any other provision of law, no funds in the retirement fund shall be expended for any purpose other than the cost of administration of the system, investments for the benefit of the system, *the reduction of employer contributions*, and the provision of benefits to the members and retired members of the system and their survivors and beneficiaries.

Cal. Gov't Code § 20203.3 (West Supp. 1992) (language added by Chapter 83 emphasized). Of course, the legislature could not similarly amend away the state constitutional provision barring the improper use of trust assets, and so it simply ignored it. It is petitioners' contention that both the prior statutory and the current state con-

stitutional bar to the improper use of trust funds created an explicit contractual right of petitioners forbidding the use of trust assets to benefit the State—a contractual right that was overridden when the State took $1.9 billion previously held in trust to pay COLA benefits, and used the money to pay employer contributions.

Respondents never attempt to explain why these "exclusive purpose" provisions are not a part of the employees' pension contract, or why they were not impaired here. In passing, they include a quote indicating that private plans commonly utilize excess investment earnings for the employer's benefit. Br. in Opp. 3-4. That argument is beside the point. Whatever the usual approach may be in private plans, it has no legal relevance to a public system that expressly forbids the use of trust funds for the employers' benefit. The contract here is what matters.

Respondents' singular focus on *Valdes* is not responsive to these concerns because the "exclusive purposes" amendment to the California Constitution was not even adopted until a year *after* that decision. *Compare* Pet. App. 27a-31a (discussing *Valdes*) *with id.* at 31a-33a (separately discussing petitioners' claim under the subsequent "exclusive purposes" amendment). That state constitutional provision—as both respondents and the court below tacitly concede—does, quite plainly, "implicate contract rights." Br. in Opp. 17; *see* Pet. App. 31a-33a. And those rights, equally plainly, were violated when the State took petitioners' money and used it to benefit itself.

Nor was it reasonable for the Court of Appeal here to conclude that this contract was not violated because the expropriated funds, in a literal sense, are ultimately used to pay benefits. As we showed in the petition (at pp. 21-22), that view amounts to nothing but a play on words and, not surprisingly, respondents have not relied on this argument in their opposition. But, while properly walking away from the court's reasoning, respondents

provide no alternative rationale to show that the employees' "exclusive purpose" contract right has not been violated. That is why, we would suggest, respondents chose to mischaracterize our argument to begin with. This studied effort to avoid the issue presented merely confirms the force of petitioners' claim.[3]

3. Respondents dispute our contention that this case raises issues of general importance because the state courts have taken widely divergent views of public employee pension rights and their relationship to the Contract Clause. *See* Pet. 25-26. *See also* Br. *Amicus Curiae* for 14 Separate Public Employee Retirement Systems (detailing the various state laws and court decisions). Respondents' cursory claim that these inconsistent views of pension rights "present no federal questions" simply confirms the obvious point that the States, understandably, would like to prevent any constitutional review when they abrogate their own contracts—by claiming that, as a matter of *state* law, the contract right never existed in the first place. That is a reason, we submit, for this Court to grant, not deny, review. The time has come to insist on some measure of uniformity in this area so that the Contract Clause, like the other provi-

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[3] Respondents add to the confusion by concluding their argument on this point with the assertion that "[c]ertiorari should be denied for want of *jurisdiction* because the redirection of IDDA-EPDA funds impaired no contract and raises no federal questions." Br. in Opp. 18-19 (emphasis added). The question whether this "redirection" impaired contract rights is, of course, a merits question and thus offers no basis to defeat jurisdiction. And the alternative suggestion that "no federal question" is presented is fully disposed of by *Indiana ex rel. Anderson v. Brand*, 303 U.S. 95, 100 (1938) ("in order that the [Contract Clause] may not become a dead letter, we are bound to decide for ourselves whether a contract was made, what are its terms and conditions, and *whether the State has, by later legislation, impaired its obligation*") (emphasis added).

sions of our Constitution, may serve more than an advisory function in this context.[4]

CONCLUSION

The petition should be granted, except as to the actuarial-control issue raised at pp. 22-25 thereof, which is now moot.

Respectfully submitted,

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[4] Several counties that have also had their pension obligations lessened as a result of Chapter 83 have filed an *amicus* brief in support of respondents. Brief of the Counties of Santa Cruz, *et al.* Their principal argument is that petitioners' claims are meritless because no "contractual rights were created" with respect to the repealed benefits. *Id.* at 5. But that suggestion simply fights the operative premise of the decision below, which was expressly to "assume" that such rights *are* implicated here. Their remaining point, also made by respondents, is that employee jobs were saved as a result of the State's impairment of its pension obligations. But that argument—always available when a State disavows a contract to save money—does not demonstrate constitutional necessity any more than would an asserted need to preserve unrelated state programs. *See United States Trust Co.*, 431 U.S. at 26 ("[i]f a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all") (footnote omitted).

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